IN THE

Supreme Court of the United States

OCTOBER TERM 1975

No. 75-1753

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC. and KIRBY LUMBER CORPORATION,

Petitioners,

against

S. WILLIAM GREEN, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

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Petitioners respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this action on February 18, 1976, as to which rehearing was denied on March 10, 1976. That judgment reversed in part a judgment of the United States District Court for the Southern District of New York, which dismissed respondents' complaint against petitioners under Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 and state law, for failure to state a claim and for lack of subject matter jurisdiction.

In denying rehearing in this and another case involving Rule 10b-5, the Court of Appeals noted:

> "This Court has denied en banc, not because we believe these cases are insignificant, but because they are

of such extraordinary importance that we are confident the Supreme Court will accept these matters under its certiorari jurisdiction, as we correctly anticipated in *Eisen* v. *Carlisle & Jacquelin,* 479 F.2d 1005, 1020 (2d Cir. 1973), *vacated,* 417 U.S. 156 (1974).

* * *

"Accordingly, we speed these cases on their way to the Supreme Court as an exercise of sound, prudent, and resourceful judicial administration." (87a-88a)*

Citations to Opinions Below

The opinion of the United States District Court for the Southern District of New York, reported at 391 F.Supp. 849, is printed as Appendix B. The opinion of the United States Court of Appeals for the Second Circuit (not yet officially reported) reversing in part the judgment of the District Court, is printed as Appendix C. The memorandum of the Court of Appeals denying rehearing *en banc* is printed as Appendix D.

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was entered on February 18, 1976. Petitioners' timely petition for rehearing was denied on March 10, 1976.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Questions Presented

1. May an action be maintained under Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder, on the basis of an allegation that the stock of minority stockholders of a company involved in a short form merger was undervalued, where there is no allegation of any misrepresentation or nondisclosure, and where it is conceded that the material facts were fully disclosed to the minority stockholders?

2. Do Section 10(b) and Rule 10b-5 authorize a federal court, in the absence of any allegation of misrepresentation or nondisclosure, to condemn, as a breach of corporate "fiduciary duty", conduct which is expressly sanctioned by the state which created the corporation, and to impose requirements of "corporate purpose" and advance notice on the use of a state short form merger statute, when it is conceded that the law of the state imposes no such requirements?

* Citations to " a" are to the Appendix to this Petition.

Statutes and Rules Involved

Involved herein are the Tenth Amendment to the Constitution of the United States, Section 10(b) of the Securities Exchange Act of 1934, 15 USC § 78j(b), Securities and Exchange Commission Rule 10b-5, 17 CFR 240.10b-5 and Sections 253 and 262 of the Delaware Corporation Law, the texts of which are printed in Appendix A hereto.

Statement of the Case

The facts relevant to the issues presented by this Petition are not in dispute. Since 1936, a controlling interest in Kirby Lumber Corporation ("Kirby"), a company organized under the laws of Delaware, was owned by Santa Fe Natural Resources, Inc. or a predecessor ("Resources") which in turn is wholly-owned by Santa Fe Industries, Inc. ("Santa Fe"), the parent company of the Santa Fe Railway. For several years, Resources had owned approximately 95 percent of the stock of Kirby. Plaintiffs were among the minority stockholders who owned the remaining 5 percent.

Delaware, like 37 other states (63a), has enacted what is commonly referred to as a "short form merger statute", which permits a parent corporation owning a substantial percentage of the stock of a subsidiary (90 percent in the case of Delaware) to merge with that subsidiary, and to pay for the minority shares in cash. As the Court below recognized (41a), the Delaware statute does not require any showing of a corporate purpose for the merger, nor does it require advance notice thereof. Notice of the merger must, however, be given within ten days after its effective date, and any stockholder who is dissatisfied with the amount of cash offered is entitled to demand an appraisal in the Delaware Court of Chancery. DCL §§ 253 (d), 262.[*]

Resources determined to invoke the provisions of Section 253. It obtained written appraisals of the physical assets of Kirby, which were furnished to Morgan Stanley & Co. in connection with its valuation of the stock (Appendix 27A-28A).[**] Morgan Stanley submitted a report valuing the stock at $125 per share. Resources thereafter decided to offer the minority stockholders $150 a share.

To implement the merger, Resources caused to be organized another Delaware corporation, Forest Products, Inc. ("FPI"), and transferred to it the funds necessary to purchase the minority shares (Appendix 18A). The merger was completed and, within the time specified by Delaware law, notice thereof was sent to the minority stockholders.

Accompanying the notice was an information statement (Appendix 12A-71A) which included, in addition to the

[*] The Delaware statute was amended on April 24, 1976. The amendments, which provide further procedural rights to stockholders seeking appraisal, do not affect the issues in this action. The text of the amendments is reprinted in Appendix A.

[**] Citations to "Appendix A" are to the Appendix on Appeal in the Second Circuit.

Morgan Stanley valuation and extensive financial data on Kirby, the appraisals of the physical assets. Respondents did not dispute herein that all of the material facts relating to the transaction were made available to the minority stockholders. As Judge Moore noted in the dissenting opinion (67a);

> "At this point it is essential to underscore what was *not* involved in the merger. [Emphasis in original.] There was no failure to comply with state law. There was no failure to disclose by the defendants. On the contrary, all of plaintiffs' assertions of stock value derived from the report circulated by the defendants to the minority shareholders. Similarly, there was no misrepresentation of fact or law made to the minority."

On August 21, 1974, the plaintiffs invoked their right of appraisal under Delaware law. On September 9, 1974, however, respondents purported to withdraw their demand for appraisal,[*] and filed the present action on the following day.

It is upon these facts that the majority of the Court below held that the complaint stated a claim under Rule 10b-5, "without any charge of misrepresentation or lack of disclosure" (36a), by alleging the absence of advance notice of the merger and the lack of a "corporate purpose" therefor, even though the law of Delaware concededly required neither, and even though there was no charge of misrepresentation or nondisclosure in connection therewith (36a).

[*] However, a number of other stockholders pressed their requests for appraisal, and discovery proceedings are now in progress in the Delaware Court of Chancery. *Bell, et al.* v. *Kirby Lumber Corporation*, C.A. No. 4076.

Thus, the majority of the Court below has made a radical transformation of Rule 10b-5 by holding, as the dissenting opinion noted (68a) "that failure to disclose is no longer a prerequisite for liability under Rule 10b-5—that, in fact, liability under the anti-fraud provisions of 10b-5 will attach in the *complete absence* of any deception or misrepresentation, in short, in the complete absence of fraud altogether." [Emphasis in original.] In holding that a scrupulous observance of the Delaware short form merger statute constituted, in itself, a device or artifice to defraud, the Court below has also taken a sweeping step toward the re-creation of a federal common law of corporations. The Court of Appeals has also opened the way for a drastic increase in the volume of litigation under Rule 10b-5, by imposing upon the federal courts the burden of determining valuation and appraisal cases, which would otherwise be heard in the state courts where they belong.

REASONS FOR GRANTING THE WRIT

The Decision of the Court Below Presents Important Federal Questions for Decision by This Court.

A. The Elimination by the Court Below of Misrepresentation and Nondisclosure, as Necessary Elements of a Claim Under Section 10(b) and Rule 10b-5, Should Be Reviewed by This Court.

The novel holding of the Court below extends the scope of Rule 10b-5 far beyond any previous authority, and raises a substantial and serious federal question. Indeed, the Court of Appeals has in effect revised the statute from a disclosure provision to a charter for the substantive regulation of state corporation law. In so doing, the Second Circuit impliedly overruled a long line of its own decisions, including *Popkin* v. *Bishop*, 464 F.2d 714 (1972).

In *Popkin,* the Court of Appeals noted, after reviewing a number of recent 10b-5 decisions (pages 719-720):

> "Thus, it seems clear that our emphasis on improper self-dealing did not eliminate non-disclosure as a key issue in Rule 10b-5 cases. Section 10(b) of the Exchange Act and Rule 10b-5 are designed principally to impose a duty to disclose and inform rather than to become enmeshed in passing judgments on information elicited."

Nothing in the prior decisions of this Court furnishes any basis for the radical break, by the Court below, with the *Popkin* line of authority. Indeed, it was less than a year before the decision below that this Court had reaffirmed the historical relationship of Rule 10b-5 to the "tort of misrepresentation and deceit". *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 744 (1975). Nor is any basis for the decision below furnished by this Court's prior holding that the "fundamental purpose" of the 1934 Act is "to substitute a policy of full disclosure for the philosophy of *caveat emptor* . . ." *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 151, citing *SEC* v. *Capital Gains Research Bureau,* 375 U.S. 180, 186.

The Court below nevertheless held that a claim had been stated under Rule 10b-5, although respondents had conceded the absence of any deceit (Principal Brief, p. 33), and had admitted that "the gravamen of [their] complaint" was merely the alleged undervaluation of their stock. Such a radical departure from prior existing law fully justified the Court of Appeals, in its *en banc* decision, in describing this case as of "such extraordinary importance" (87a) that it was deserving of early review by this Court.

The holding of the majority below is not only novel and serious in its potential consequences: it also is in apparent conflict with general principles most recently stated by this

Court in *Ernst & Ernst* v. *Hochfelder,* —— U.S. ——, 44 U.S. Law Week, 4451, 4455 (March 30, 1976). Indeed, the holding below appears to conflict with the language of the statute itself.

As the Court noted in *Hochfelder,* any construction of Rule 10b-5 must "turn first to the language of § 10(b), for '[t]he starting point in every case involving construction of a statute is the language itself' ". 44 U.S. Law Week, page 4455, quoting *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 756. That statute, as the Court further noted in *Hochfelder,* makes unlawful the use of "any *manipulative or deceptive* device or contrivance" [emphasis added] in contravention of rules established by the Commission. But no allegation of manipulation, as the term is used in the statute, is here involved.* The issue, therefore, is whether the statute which prohibits "deceptive" devices can be stretched to cover cases where there is a conceded absence of any deception whatsoever.

The Court of Appeals sought to fill this gap by finding and substituting a breach of fiduciary duty in place of the requisite deceit. Thus, it imported into the statute a requirement that a short form merger must be accompanied by an express corporate purpose and that notice of such a merger be given in advance, although neither of these requirements is in the statute. The fiduciary breach then was found in the absence of compliance with these judicially created requirements. In so doing the majority, as Judge Moore stated (80a), "has not provided a remedy to correct a fraud; rather it has extended to these plaintiffs an independent, substantive right totally unrelated to the anti-fraud scheme of the federal securities laws."

* As this Court noted in the *Hochfelder* case, 44 U.S. Law Week, page 4456, the term "manipulative" was "virtually a term of art . . . [relating to] conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities".

Petitioners submit further that the grave questions raised by the decision below are not answered by asserting that Rule 10b-5 "must be read flexibly, not technically and restrictively" (42a-43a). Undoubtedly, the statute can be read "flexibly" to reach new and ingenious forms of fraud and deceit. Flexible interpretation, however, cannot validly be stretched to "add a gloss to the operative language of the statute quite different from its commonly accepted meaning." *Hochfelder, supra,* at page 4455. As the Court further held in *Hochfelder,* page 4460:

> "More importantly, Rule 10b-5 was adopted pursuant to authority granted the Commission under § 10(b). The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute,' *Dixon* v. *United States,* 381 U.S. 68, 74 (1965), quoting *Manhattan General Equipment Co.* v. *Commissioner,* 297 U.S. 129, 134 (1936). Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b)."

So here, the Court below, in eliminating deception as a requirement under the Rule, has exceeded the authority granted by Congress in Section 10(b). Petitioners submit that the principle stated in *Hochfelder* is controlling here, and that the Court of Appeals, like the Commission, is without authority to rewrite the statute. Petitioners respectfully urge that this Court should resolve the question of whether a statute which "speaks so specifically in terms of manipulation and deception" (*Hochfelder, supra,* page 4460) can be construed to apply to situations where manipulation and deception are concededly absent.

The decision of the Court below is also in direct conflict with the holdings of the Fifth and Seventh Circuits that

"the gravamen of a 10b-5 cause of action is deception", and that no action under the Rule may be maintained in the absence thereof. *Bailes* v. *Colonial Press, Inc.,* 444 F.2d 1241, 1246 (5th Cir. 1971). *Accord, Rosin* v. *New York Stock Exchange, Inc.,* 484 F.2d 179, 183 (7th Cir. 1973), *cert denied,* 415 U.S. 977. *See, also, Aboussie* v. *Aboussie,* 441 F.2d 150 (5th Cir. 1971); *Azalea Meats, Inc.* v. *Muscat,* 386 F.2d 5, 8 (5th Cir. 1967).* Petitioners submit that this is a further indication of the substantial and serious nature of the issue presented, and of the need for a resolution by this Court.

And finally, the decision below would vastly increase the volume of federal litigation under the securities laws. The holding of the majority (36a), that an action may be brought under Rule 10b-5 for "breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure" would mean that the District Court will henceforth be obliged to hear, as purported claims under the securities laws, a wide variety of claims which previously have been matters for state law exclusively. In reaching this result, the majority of the Court below has disregarded "the danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5" (See *Blue Chip Stamps* v. *Manor Drug Stores, supra,* at 421 U.S. 740). Petitioners submit that the radical expansion of the Rule by the decision below calls for the exercise of this Court's supervisory powers.

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* The concurring opinion in the Court below cited *Rekant* v. *Desser,* 425 F.2d 872 (5th Cir. 1970), for the proposition that the Fifth Circuit has ruled 10b-5 applicable to "corporate insiders" even in the absence of misrepresentation or nondisclosure (61a). In *Rekant,* however, the Fifth Circuit expressly based its holding on findings that the defendants had made "affirmative misrepresentations" in reports to shareholders, and had "violated the directors' duty to disclose fully the material facts . . ." (425 F.2d at page 882).

B. The Decision of the Court Below Would Create a Federal Common Law of Corporations Contrary to Valid State Statutes.

The majority of the Court below held that the complaint sufficiently pleaded a breach of corporate "fiduciary duty", in alleging that the short form merger was implemented without advance notice to minority shareholders, and without a valid corporate purpose (45a, 47a-48a). The Court below specifically recognized that the applicable Delaware statute provides for elimination of minority interests under 10 percent "without prior notice to the minority shareholders" and "without any statement of corporate purpose" (40a). The majority nevertheless proceeded to hold that following the short form merger procedure, expressly sanctioned by the legislature and Courts of Delaware, constituted in itself a "fraud" and breach of "fiduciary duty" as a matter of federal law. It did so in a situation where the Supreme Court of Delaware has clearly held that no such fiduciary duty exists, and that the holders of a less than 10 percent minority interest have no vested right to remain stockholders. *See, e.g., Stauffer* v. *Standard Brands Inc.,* 187 A.2d 78, 80 (Del. Sup. Ct. 1962). ("This power of the parent corporation to eliminate the minority is a complete answer to plaintiff's charge of breach of trust. . . .")

Petitioners submit that the holding below is in direct conflict with the spirit of applicable decisions of this Court, from *Erie R. Co.* v. *Tompkins,* 304 U.S. 64, to *Cort* v. *Ash,* 422 U.S. 66. In seeking to transform Section 10(b) and Rule 10b-5 from disclosure provisions to charters for the substantive revision of state corporate law, the majority was clearly moved by its disapproval of the policy underlying Delaware statutes "thought to be favorable to corporate management and designed to attract corporations to the state for the purpose, among others, of raising revenue for the state and furnishing business for the mem-

bers of the legal profession located in Delaware" (40a).* The issue thus is squarely presented as to whether Section 10(b) authorizes, in the words of the dissenting opinion below (63a), "the use of their powers by two judges of one of the eleven judicial Circuits to override and nullify not only the corporate laws of Delaware with respect to short-form corporate mergers, but also, in effect, comparable laws in an additional thirty-seven States". Petitioners submit that it does not, and that the attempted re-creation of a federal common law of corporations clearly calls for review by this Court. As this Court held in *Cort* v. *Ash, supra,* in disallowing a federal civil damage remedy for illegal corporate political contributions (pp. 84-5):

> "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.
>
> * * *
>
> "We are necessarily reluctant to imply a federal right to recover funds used in violation of a federal statute where the laws governing the corporation may put a shareholder on notice that there may be no such recovery."

See, also, Cohen v. *Beneficial Loan Corp.,* 337 U.S. 541, 550-1.

In the absence of any showing of congressional intent to preempt this area—and no such showing, as indicated above, can be derived from the language of the statute—it is irrelevant whether the Court below was right or wrong in its disapproval of the policy judgments embodied in the

* In fact, as noted in Judge Moore's dissent (63a), at least 38 of the 50 states have similar statutes.

Delaware statute. As this Court recently held, in disapproving another excursion by the Second Circuit into the fashioning of state corporation law (*Lehman Bros.* v. *Schein,* 416 U.S. 386, 389):

> "Such a construction of *Diamond,* the Court of Appeals said, would have 'the prophylactic effect of providing a disincentive to insider trading.' Id., at 823. And so it would. Yet under the regime of *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938), a State can make just the opposite her law, providing there is no overriding federal rule which preempts state law by reason of federal curbs on trading in the stream of commerce."

The dangers of creating federal common law in this area were forcefully stated in a recent commentary, cited, curiously enough, by the majority of the Court below. Borden, *Going Private—Old Tort, New Tort or No Tort?* 49 N.Y.U. L.Rev. 987 (1975). After recalling the unfortunate developments under the doctrine of *Swift* v. *Tyson,* Professor Borden noted (p. 1039):

> "If the federal securities laws are to be pushed so far beyond their original purpose as not only to enforce recognized standards of fiduciary obligations but to create new ones in a hotly debated area without deference to state law or empirical study of any balancing of the numerous competing social interests involved, one may suppose that one day there will again be a recognition of the 'mischievous result' of judicial law-making based upon an alleged 'transcendental body of law outside of any particular State' which federal courts in their good judgment may discern and apply. We will then have in the securities field our own *Erie* v. *Tompkins.*" [Footnotes omitted.]

We submit that this outcome should not wait for a demonstration of the "mischievous results" which would

follow from a revival of *Swift* v. *Tyson* in this area. Petitioners respectfully urge this Court to halt such a development in its incipiency, by reviewing and then reversing the decision below.

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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Appendix A—Statutes and Rules Involved.

UNITED STATES CONSTITUTION AMENDMENT X

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

RULE 10b-5

§ 240.10b—5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security. (Sec. 10; 48 Stat. 891; 15 U.S.C. 78j) [13 F.R. 8183, Dec. 22, 1948, as amended at 16 F.R. 7928, Aug. 11, 1961]

DELAWARE CORPORATION LAW

§ 253. Merger of parent corporation and subsidiary or subsidiaries

(a) In any case in which at least 90 percent of the outstanding shares of each class of the stock of a corporation or corporations is owned by another corporation and one of such corporations is a corporation of this State and the other or others are corporations of this State or of any other state or states or of the District of Columbia and the laws of such other state or states or of the District permit a corporation of such jurisdiction to merge with a corporation of another jurisdiction, the corporation having such stock ownership may either merge such other corporation or corporations into itself and assume all of its or their obligations, or merge itself, or itself and one or more of such other corporations, into one of such other corporations by executing, acknowledging and filing, in accordance with section 103 of this title, a certificate of such ownership and merger setting forth a copy of the resolution of its board of directors to so merge and the date of the adoption thereof; provided, however, that in case the parent corporation shall not own all the outstanding stock of all the subsidiary corporations, parties to a merger as aforesaid,

the resolution of the board of directors of the parent corporation shall state the terms and conditions of the merger, including the securities, cash, property, or rights to be issued, paid, delivered or granted by the surviving corporation upon surrender of each share of the subsidiary corporation or corporations not owned by the parent corporation. If the parent corporation be not the surviving corporation, the resolution shall include provision for the pro rata issuance of stock of the surviving corporation to the holders of the stock of the parent corporation on surrender of the certificates therefor, and the certificate of ownership and merger shall state that the proposed merger has been approved by a majority of the outstanding stock of the parent corporation entitled to vote thereon at a meeting thereof duly called and held after 20 days' notice of the purpose of the meeting mailed to each such stockholder at his address as it appears on the records of the corporation. A certified copy of the certificate shall be recorded in the office of the Recorder of the County in this State in which the registered office of each constituent corporation which is a corporation of this State is located. If the surviving corporation exists under the laws of the District of Columbia or any state other than this State, the provisions of section 252(d) of this title shall also apply to a merger under this section.

(b) If the surviving corporation is a Delaware corporation, it may change its corporate name by the inclusion of a provision to that effect in the resolution of merger adopted by the directors of the parent corporation and set forth in the certificate of ownership and merger, and upon the effective date of the merger, the name of the corporation shall be so changed.

(c) The provisions of Section 251(d) of this title shall apply to a merger under this section, and the provisions of Section 251(e) shall apply to a merger under this section

in which the surviving corporation is the subsidiary corporation and is a corporation of this State. Any merger which effects any changes other than those authorized by this section or made applicable by this subsection shall be accomplished under the provisions of Section 251 or Section 252 of this title. The provisions of Section 262 of this title shall not apply to any merger effected under this section, except as provided in subsection (d) of this section.

(d) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under this section is not owned by the parent corporation immediately prior to the merger, the surviving corporation shall, within 10 days after the effective date of the merger, notify each stockholder of such Delaware corporation that the merger has become effective. The notice shall be sent by certified or registered mail, return receipt requested, addressed to the stockholder at his address as it appears on the records of the corporation. Any such stockholder may, within 20 days after the date of mailing of the notice, demand in writing from the surviving corporation payment of the value of his stock exclusive of any element of value arising from the expectation or accomplishment of the merger. If during a period of 30 days after such period of 20 days the surviving corporation and any such objecting stockholder fail to agree as to the value of such stock, any such stockholder or the corporation may file a petition in the Court of Chancery as provided in subsection (c) of section 262 of this title and thereupon the parties shall have the rights and duties and follow the procedure set forth in subsections (d) to (j) inclusive of section 262.

(e) A merger may be effected under this section although one or more of the corporations parties to the merger is a corporation organized under the laws of a jurisdiction other than one of the United States; provided that the laws of such jurisdiction permit a corporation of such juris-

diction to merge with a corporation of another jurisdiction; and provided further that the surviving or resulting corporation shall be a corporation of this State.

(As amended by Ch. 186, Laws of 1967, Ch. 148, Laws of 1969 and Ch. 106, Laws of 1973.)

§ 262. Payment for stock or membership of person objecting to merger or consolidation

(a) When used in this section, the word "stockholder" means a holder of record of stock in a stock corporation and also a member of record of a non-stock corporation; the words "stock" and "share" mean and include what is ordinarily meant by those words and also membership or membership interest of a member of a non-stock corporation.

(b) The corporation surviving or resulting from any merger or consolidation shall within 10 days after the effective date of the merger or consolidation, notify each stockholder of any corporation of this State so merging or consolidating who objected thereto in writing and whose shares either were not entitled to vote or were not voted in favor of the merger or consolidation, and who filed such written objection with the corporation before the taking of the vote on the merger or consolidation, that the merger or consolidation has become effective. Such notice shall likewise be given to each stockholder whose corporation approved the merger or consolidation pursuant to section 228 of this title without a meeting of its stockholders and who either did not, or had no right to, consent in writing to such merger or consolidation. If any such stockholder shall within 20 days after the date of mailing of the notice demand in writing, from the corporation surviving or resulting from the merger or consolidation, payment of the value of his stock, the surviving or resulting corporation shall, within 30 days after the expiration of the period of 20 days,

pay to him the value of his stock on the effective date of the merger or consolidation, exclusive of any element of value arising from the expectation or accomplishment of the merger or consolidation.

(c) If during a period of 30 days following the period of 20 days provided for in subsection (b) of this section, the corporation and any such stockholder fail to agree upon the value of such stock, any such stockholder, or the corporation surviving or resulting from the merger or consolidation, may, by petition filed in the Court of Chancery within four months after the expiration of the period of 30 days, demand a determination of the value of the stock of all such stockholders by an appraiser to be appointed by the Court.

(d) Upon the filing of any such petition by a stockholder, service of a copy thereof shall be made upon the corporation, which shall within ten days after such service file in the office of the Register in Chancery in which the petition was filed a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached by the corporation. If the petition shall be filed by the corporation, the petition shall be accompanied by such a duly verified list. The Register in Chancery shall give notice of the time and place fixed for the hearing of such petition by registered or certified mail to the corporation and to the stockholder shown upon the list at the addresses therein stated, and notice shall also be given by publishing a notice at least once at least one week before the day of the hearing, in a newspaper of general circulation published in the City of Wilmington, Delaware. The Court may direct such additional publication of notice as it deems advisable. The forms of the notices by mail and by publication shall be approved by the Court.

(e) After the hearing on such petition the Court shall determine the stockholders who have complied with the provisions of this section and become entitled to the valuation of and payment for their shares, and shall appoint an appraiser to determine such value. Such appraiser may examine any of the books and records of the corporation or corporations the stock of which he is charged with the duty of valuing, and he shall make a determination of the value of the shares upon such investigation as to him seems proper. The appraiser shall also afford a reasonable opportunity to the parties interested to submit to him pertinent evidence on the value of the shares. The appraiser, also, shall have such powers and authority as may be conferred upon masters by the rules of the Court of Chancery or by the order of his appointment.

(f) The appraiser shall determine the value of the stock of the stockholders adjudged by the Court of Chancery to be entitled to payment therefor and shall file his report respecting such value in the office of the Register in Chancery and notice of the filing of such report shall be given by the Register in Chancery to the parties in interest. Such report shall be subject to exceptions to be heard before the Court both upon the law and facts. The Court shall by its decree determine the value of the stock of the stockholders entitled to payment therefor and shall direct the payment of such value, together with interest, if any, as hereinafter provided, to the stockholders entitled thereto by the surviving or resulting corporation upon the transfer to it of the certificates representing such stock, which decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any other state.

(g) At the time of appointing the appraiser or at any time thereafter the Court may require the stockholders who

demanded payment for their shares to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings, and if any stockholder fails to comply with such direction the Court may dismiss the proceedings as to such stockholder.

(h) The cost of any such appraisal, including a reasonable fee to and the reasonable expenses of the appraiser, but exclusive of fees of counsel or of experts retained by any party, may on application of any party in interest be determined by the Court and taxed upon the parties to such appraisal or any of them as appears to be equitable, except that the cost of giving the notice by publication and by registered mail hereinabove provided for shall be paid by the corporation. The Court may, on application of any party in interest, determine the amount of interest, if any, to be paid upon the value of the stock of the stockholders entitled thereto.

(i) Any stockholder who has demanded payment of his stock as herein provided shall not thereafter be entitled to vote such stock for any purpose or be entitled to the payment of dividends or other distribution on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation) unless the appointment of an appraiser shall not be applied for within the time herein provided, or the proceeding be dismissed as to such stockholder, or unless such stockholder shall with the written approval of the corporation deliver to the corporation a written withdrawal of his objections to and an acceptance of the merger or consolidation, in any of which cases the right of such stockholder to payment for his stock shall cease.

(j) The shares of the surviving or resulting corporation into which the shares of such objecting stockholders would

have been converted had they assented to the merger or consolidation shall have the status of authorized and unissued shares of the surviving or resulting corporation.

(k) This section shall not apply to the shares of any class or series of a class of stock, which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders at which the agreement of merger or consolidation is to be acted on, were either (1) listed on a national securities exchange, or (2) held of record by more than 2,000 stockholders, unless the certificate of incorporation of the corporation issuing such stock shall otherwise provide; nor shall this section apply to any of the shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation, as provided in subsection (f) of Section 251 of this title. This subsection shall not be applicable to shares of any class or series of a class of stock of a constituent corporation if under the terms of a merger or consolidation pursuant to Section 251 or Section 252 of this title the holders thereof are required to accept for such stock anything except (a) shares of stock or shares of stock and cash in lieu of fractional shares of the corporation surviving or resulting from such merger or consolidation; or (b) shares of stock or shares of stock and cash in lieu of fractional shares of any other corporation, which at the effective date of the merger or consolidation will be either (1) listed on a national securities exchange or (2) held of record by more than 2,000 stockholders; or (c) a combination of shares of stock or shares of stock and cash in lieu of fractional shares as set forth in (a) and (b) of this subsection.

(As amended by Ch. 186, Laws of 1967, Ch. 148, Laws of 1969 and Ch. 106, Laws of 1973.)

Amendments to Sections 253 and 262 of the
Delaware Corporation Law
as of April 24, 1976

Section 2. Amend § 253(d), Subchapter IX, Chapter 1, Title 8, Delaware Code, by striking said subsection (d) in its entirety and substituting in lieu thereof a new subsection (d) to read as follows:

"(d) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under this Section is not owned by the parent corporation immediately prior to the merger, the stockholders of the subsidiary Delaware corporation party to the merger shall have appraisal rights and the surviving corporation shall comply with the provisions of subsection (b)(2) of § 262 of this Title. Thereafter, the surviving corporation and the stockholders shall have such rights and duties and shall follow the procedures set forth in subsections (c) to (j), inclusive, of § 262 of this Title."

Section 3. Amend § 262(a), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (a) in its entirety and substituing in lieu thereof a new subsection (a) to read as follows:

"(a) Appraisal rights under this Section shall be available only for the shares of any stockholder who has complied with the provisions of subsection (b) of this Section and has neither voted in favor of the merger nor consented thereto in writing pursuant to § 228. When used in this Section, the word 'stockholder' means a holder of record of stock in a stock corporation and also a member of record of a non-stock corporation; the words 'stock' and 'share' mean and include what is ordinarily meant by those words

and also membership or membership interest of a member of a non-stock corporation."

Section [redacted] § 262(b), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (b) in its entirety and substituting in lieu thereof a new subsection (b) to read as follows:

"(b) Appraisal rights under this Section shall be determined as follows:

(1) If a proposed merger or consolidation for which appraisal rights are provided under this Section is to be submitted for approval at a meeting of stockholders, the corporation, not less than 20 days prior to the meeting, shall notify each of its stockholders entitled to such appraisal rights that appraisal rights are available for any or all of the shares of the constituent corporations, and shall include in such notice a copy of this Section. Each stockholder electing to demand the appraisal of his shares under this Section shall deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal of his shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of his shares; provided, however, that such demand must be in addition to and separate from any proxy or vote against the merger. Within 10 days after the effective date of such merger or consolidation, the surviving corporation shall notify each stockholder of each constituent corporation who has complied with the provisions of this subsection and has not voted in favor of or consented to the merger or consoli-

dation of the date that the merger or consolidation has become effective; or

(2) If the merger or consolidation was approved pursuant to § 228 or § 253 of this Chapter, the surviving corporation, either before the effective date of the merger or within 10 days thereafter, shall notify each of the stockholders entitled to appraisal rights of the effective date of the merger or consolidation that appraisal rights are available for any or all of the shares of the constituent corporations. A copy of this Section shall be included in the notice. The notice shall be sent by certified or registered mail, return receipt requested, addressed to the stockholder at his address as it appears on the records of the corporation. Any stockholder entitled to appraisal rights may, within 20 days after the date of mailing of the notice, demand in writing from the surviving corporation the appraisal of his shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of his shares."

Section 5. Amend § 262(c), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (c) in its entirety and substituting in lieu thereof a new subsection (c) to read as follows:

"(c) Within 120 days after the effective date of the merger or consolidation, the corporation or any stockholder who has complied with the provisions of subsections (a) and (b) hereof and who is otherwise entitled to appraisal rights under this Section, may file a petition in the Court of Chancery demanding a determination of the value of the stock of all such stockholders. Notwithstanding the foregoing, at any

time within 60 days after the effective date of the merger or consolidation, any stockholder shall have the right to withdraw his demand for appraisal and to accept the terms offered upon the merger or consolidation."

Section 6. Amend § 262(e), Subchapter IX, Chapter 1, Title 8, Delaware Code, by striking said subsection (e) in its entirety and substituting in lieu thereof a new subsection (e) to read as follows:

"(e) After the hearing on such petition, the Court shall determine the stockholders who have complied with the provisions of this Section and who have become entitled to appraisal rights under this Section. The Court may require the stockholders who demanded payment for their shares to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings; and if any stockholder fails to comply with such direction, the Court may dismiss the proceedings as to such stockholder."

Section 7. Amend § 262(f), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (f) in its entirety and substituting in lieu thereof a new subsection (f) to read as follows:

"(f) After the determination of the stockholders entitled to an appraisal, the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger. Upon application by any stockholder entitled to participate in the appraisal proceeding or by the corporation, the Court may, in its discretion, permit discovery or other pretrail proceedings and may proceed to trial upon the appraisal prior

to the final determination of those other stockholders who have complied with this Section. Any stockholder whose name appears on the list filed by the corporation pursuant to subsection (d) of this Section and who has submitted his certificates of stock to the Register in Chancery, if such is required, may participate fully in all proceedings until the Court shall determine that he is not entitled to appraisal rights under this Section."

Section 8. Amend § 262(g), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (g) in its entirety and substituting in lieu thereof a new subsection (g) to read as follows:

"(g) The Court shall direct the payment of the appraised value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto upon the surrender to the corporation of the certificates representing such stock. The Court's decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any other State."

Section 9. Amend § 262(h), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (h) in its entirety and substituting in lieu thereof a new subsection (h) to read as follows:

"(h) The costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances. Upon the application of any party in interest, the Court shall determine the amount of interest, if any, to be paid upon the value of the stock of the stockholders entitled thereto. In making its determination with respect to

interest, the Court may consider all relevant factors, including the rate of interest which the corporation has paid for money it has borrowed, if any, during the pendency of the proceeding. Upon application of a stockholder, the Court may order all or a portion of the expenses incurred by any stockholder in connection with the appraisal proceeding, including, without limitation, reasonable attorney's fees and the fees and expenses of experts, to be charged pro rate against the value of all of the shares entitled to an appraisal."

Section 10. Amend § 262(i), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (i) in its entirety and substituting in lieu thereof a new subsection (i) to read as follows:

"(i) Any stockholder who has demanded his appraisal rights as provided in subsection (b) of this Section shall thereafter neither be entitled to vote such stock for any purpose nor be entitled to the payment of dividends or other distribution on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation); provided, however, that if no petition for an appraisal shall be filed within the time provided in subsection (c) of this Section, or if such stockholder shall deliver to the corporation a written withdrawal of his demand for an appraisal and an acceptance of the merger or consolidation, either within 60 days after the effective date of the merger or consolidation as provided in subsection (c) of this Section or thereafter with the written approval of the corporation, then the right of such stockholder to appraisal shall cease. Notwithstanding the foregoing, no appraisal proceeding in the Court of Chancery shall be dismissed as to any stockholder with-

out the approval of the Court, and such approval may be conditioned upon such terms as the Court deems just."

Section 11. Amend § 262(k), Subchapter IX, Chapter 1, Title 8, Delaware Code by striking said subsection (k) in its entirety and substituting in lieu thereof a new subsection (k) to read as follows:

"(k) Unless otherwise provided in the certificate of incorporation of the corporation issuing such shares, no appraisal rights under this Section shall be available for the shares of any class or series of stock which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders to act upon the agreement of merger or consolidation, were either (1) listed on a national securities exchange or (2) held of record by more than 2,000 stockholders. No appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation as provided in subsection (f) of § 251 of this Title."

Section 12. Amend § 262, Subchapter IX, Chapter 1, Title 8, Delaware Code by adding thereto a new subsection to be designated as subsection (l) to read as follows:

"(l) Notwithstanding the provisions of subsection (k) of this Section, appraisal rights under this Section shall be available for the shares of any class or series of stock of a constituent corporation if the holders thereof are required by the terms of an agreement of merger or consolidation pursuant to § 251 or § 252 of this Title to accept for such stock anything except (1)

shares of stock of the corporation surviving or resulting from such merger or consolidation; (2) shares of stock of any other corporation which at the effective date of the merger or consolidation will be either listed on a national securities exchange or held of record by more than 2,000 shareholders; (3) cash in lieu of fractional shares of the corporations described in clauses (1) and (2) of this subsection; or (4) any combination of the shares of stock and cash in lieu of fractional shares described in clauses (1), (2) and (3) of this subsection."

Appendix B—Opinion of the District Court.

S. William Green, et al.,
Plaintiffs,

v.

Santa Fe Industries, Inc., et al.,
Defendants.
No. 74 Civ. 3915 CLB.

United States District Court,
S. D. New York.
March 27, 1975.

Leventritt, Lewittes & Bender by Sidney Bender, New York City, for plaintiffs.

Rogers & Wells, New York City by William R. Glendon and Guy C. Quinlan, New York City, for defendants Santa Fe Industries, Inc., Santa Fe Natural Resources, Inc. and Kirby Lumber Corp.

Davis, Polk & Wardwell by S. Hazard Gillespie, James W. B. Benkard, and Charles R. Morgan, New York City, for defendant Morgan Stanley & Co.

Memorandum and Order

Brieant, District Judge.

Plaintiffs seek to maintain this purported class action on behalf of all of the former shareholders of Kirby Lumber Corporation ("Kirby"), a Delaware corporation, who were offered or received cash for their shares when Kirby and Forest Products, Inc. ("FPI") were merged. Plaintiffs also sue derivatively to enfore the rights of Kirby as it existed prior to the merger (hereinafter "Old Kirby").

Jurisdiction is premised on § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa; this Court's jurisdic-

tion depends, therefore, upon the existence of a cognizable claim under Rule 10b-5. Plaintiffs also assert that this Court has pendent jurisdiction over related claims of the defendants' breach of their fiduciary duties. The complaint asserts jurisdiction by reason of diversity of citizenship, but complete diversity does not exist, as is conceded in ¶ 1 of the first amended complaint.

Defendants moved for an order pursuant to Rules 12(b)(1), and (6), F.R.Civ.P., dismissing the amended complaint for lack of subject matter jurisdiction and for failure to state a claim upon which relief can be granted. Alternatively, defendants seek dismissal of the amended complaint for failure to satisfy Rule 9(b), F.R.Civ.P., because it does not state the circumstances constituting the claimed fraud with sufficient particularity.

The amended complaint shows that defendant Santa Fe Industries, Inc. owns all of the capital stock of Santa Fe Natural Resources, Inc., which, in turn, owned approximately 95% of the voting shares of Old Kirby. On July 11, 1974, Santa Fe Resources caused FPI to incorporate in Delaware. On July 29, 1974, FPI issued 1,000 shares [all] of its stock to Santa Fe Resources and received in return 474,675½ shares of Kirby which constituted approximately 95% of Kirby's shares, and all of those shares then owned by Santa Fe Resources. FPI also received $3,798,675.00 in cash and assumed expenses arising as a result of the contemplated merger of FPI and Kirby to form New Kirby. On July 30, 1974, the board of directors of FPI, the same persons who comprised the board of directors of Santa Fe Resources, adopted a resolution, pursuant to § 253 of the Delaware Corporation Law, that state's short-form merger statute, providing that FPI be merged into Kirby with Kirby surviving the merger. Shareholders of Old Kirby, other than FPI, would become entitled to $150.00 in cash per Kirby share held, and would cease being shareholders of Kirby effective immediately. On the next day the cus-

tomary Certificate of Ownership and Merger was filed with the Secretary of State of the State of Delaware, and the merger became effective, thereby extinguishing, or "freezing out" the minority shareholders of Kirby.

On August 1, 1974, New Kirby mailed to each former minority shareholder a notice of merger and an information statement consisting of 33 pages and supplementary exhibits. The information statement contained the terms of the plan of merger, a statement of Kirby's income, appraisals of the value of Kirby's stock and its assets, and a history of the prior dealings between Kirby and Santa Fe Industries and its affiliates. Exhibit C attached to the information statement is a copy of a letter from defendant Morgan, Stanley & Co. in which Morgan, Stanley, after consideration of Kirby's audited financial statements for the five years ending December 31, 1973, its unaudited financial statements for the four-month period ending April 30, 1974, its five-year forecast for 1974-78, and appraisals of Kirby's properties and mineral rights, placed a value on the minority shareholders' stock at $125.00 a share, adjusting for the assumption that Kirby's shares were broadly distributed and freely traded at prices within the range of prices typical of similar publicly held companies. The information statement also advised the minority shareholders that they could elect not to accept the terms of the offer, and instead seek a judicial appraisal in Delaware of the value of their shares. The information statement clearly described the time limitations within which the dissenting shareholders were to note their objection, and the time within which the appraisal action was to be commenced; it also included the text of the Delaware appraisal statute, Del.Gen.Corp.Law, § 262.

In their complaint, plaintiffs allege that the merger, its statutory means of effectuation and the cash exchange offered, constituted a "device, scheme or artifice to defraud" in violation of Rule 10b-5. Plaintiffs contend that, with

knowledge that the $150.00 a share offer understated the value of the physical assets of Kirby and therefore did not represent the true value of Kirby shares, Kirby and the Santa Fe affiliates obtained and submitted to the minority shareholders the $125.00 a share valuation from Morgan, Stanley "in order to lull the minority stockholders into erroneously believing (sic) that defendants were generous." (Complaint, ¶ 9). It is alleged further that Morgan, Stanley assisted knowingly and facilitated the fraud.

Plaintiffs' allegations have two distinct aspects. First, it is alleged that the means of effectuating this merger operated as a fraud on the minority shareholders in that the merger was consummated for the benefit of the majority shareholders, without any justifiable business purpose, except to freeze out the minority, and was effected without prior notice to the minority shareholders. Second, plaintiffs allege that the low valuation placed on their shares in the cash exchange offer segment of the merger transaction was in itself a fraud actionable under Rule 10b-5.

Plaintiffs' attack upon the Delaware short-form merger procedure based, as it is, upon Rule 10b-5 is without merit. The General Corporation Law of the State of Delaware permits a parent corporation to merge with another corporation, 90% of whose shares are owned by the parent, by executing and filing a certificate of ownership and merger together with a copy of the resolution of the board of directors of the parent. Del.Gen.Corp.Law, § 253 (a). *See generally,* N.Y.B.C.L., § 905 (McKinney's Consol. Laws, c. 4, Supp.1974); Stauffer v. Standard Brands Incorporated, 41 Del. Ch. 7, 187 A.2d 78 (Del.Sup.Ct.1962). The resolution of the board of directors may provide that minority shareholders are to receive cash in payment for their shares in the subsidiary although this has the effect of causing these shareholders to make a forced sale. See Vine v. Beneficial Finance Company, 374 F.2d 627 (2d Cir. 1967). Plaintiffs did not have a vested right to remain

shareholders of Kirby. Coyne v. Park & Tilford Distillers Corporation, 37 Del.Ch. 558, 146 A.2d 785 (Del.Ch.1958), aff'd, 38 Del.Ch. 514, 154 A.2d 893 (Del.Sup.Ct.1959); Matter of Willcox v. Stern, 18 N.Y.2d 195, 273 N.Y.S.2d 38, 219 N.E.2d 401 (1966). The corporation law of a state may permit minority shareholders to be "frozen out" or to be "frozen in." Garzo v. Maid of the Mist Steamboat Co., 303 N.Y. 516, 104 N.E.2d 882 (1952). The Delaware corporation law does not require that the merger be effected for a business purpose. The statute reflects the public policy of Delaware with respect to rights of splinter interests in corporations. The Court does not view Rule 10b-5 as requiring a federal district court to analyze the motives of corporate directors, at least not in the absence of actual fraud and deceit. See Grimes v. Donaldson, Lufkin & Jenrette, Inc., Fed.Sec.L.Rep., ¶ 94,722 (N.D.Fla.1974); *cf.* Bryan v. Brock & Blevins Co., Inc., 490 F.2d 563 (5th Cir. 1974). "[T]he very purpose of the [Delaware short-form merger] statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise." Stauffer v. Standards Brands Incorporated, *supra,* 187 A.2d 80. See generally Borden, "Going Private—Old Tort, New Tort or No Tort?", 49 N.Y.U.L. Rev. 987 (1974).

When a merger is effected under this statute and all of the subsidiary's shares are not owned by the parent corporation, the merger statute requires that the surviving corporation *"within 10 days after the effective date* of the merger, notify each shareholder . . . that the merger has become effective," Del.Gen.Corp.Law, § 253(d) (emphasis added); Carl Marks & Co. v. Universal City Studios, Inc., 233 A.2d 63 (Del.Sup.Ct.1967). It is not contended that Kirby failed to comply with this notice requirement, rather it is argued that the anti-fraud provisions of the 1934 Act require prior notice and disclosure to the minority shareholders. The primary objective of Rule 10b-5 is to impose

a duty of disclosure upon a corporation and its controlling persons. Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972). That objective is to be achieved in conjunction with the state corporate law. This Court does not regard Rule 10b-5 as an omnibus federal corporation law having such broad reach as to modify the notice requirements of the Delaware merger statute, or prevent Delaware, in its legislative wisdom, from providing a means by which a majority can exclude a minority from the corporation's future affairs, so long as due process is satisfied, as it is here, by the appraisal procedures.

Plaintiffs contend further that the corporate defendants knowingly obtained an appraisal from defendant Morgan, Stanley which undervalued the worth of their Kirby stock so drastically as to be a fraud within the purview of Rule 10b-5. Plaintiffs value their shares at a minimum of $772.00 each, basing this figure on the *pro rata* value of Kirby's physical assets. For purposes of this motion the Court accepts plaintiffs' claimed valuation, although the propriety of using the liquidation value of Kirby's physical assets as the sole basis for determining the true worth of the shares owned by the minority shareholders is at least questionable. See In re Olivetti Underwood Corporation, 246 A.2d 800, 803 (Del.Ch. 1968); Application of Delaware Racing Association, 213 A.2d 203 (Del.Sup.Ct. 1965).

Accepting plaintiffs' valuation, the amended complaint, upon its face, fails to allege a course of fraudulent conduct.[1] In paragraph seven of their complaint, plaintiffs acknowledged that their valuation is based upon information provided by the corporate defendants in the merger information statement. The appraisal made by

[1] On oral argument, plaintiffs conceded that if the differential between price and true value was so slight that reasonable minds could differ, no action would lie under Rule 10b-5.

defendant Morgan, Stanley details the information upon which it relied in computing the value of the minority's shares in Kirby. Among the considerations relied upon by Morgan, Stanley were the values of Kirby's physical assets provided by Appraisal Associates and Riggs and Associates. The opinions of the latter two firms were appended to the merger information statement as Exhibits D and E, and the entire report of Appraisal Associates was available for inspection at the offices of Santa Fe Resources. The appraisal opinions, and detailed financial information, were provided for the minority shareholders' use in evaluating the merits of the cash exchange offer and in determining whether to seek their appraisal rights as dissenting shareholders.

Without passing upon the proper valuation of the Kirby shares, it is noteworthy that the information statement divulged the history of purchases of Kirby stock by the Santa Fe affiliates. Following the paradigm of "going private" transactions, an affiliate of Santa Fe made a tender offer for the shares of Kirby in 1967 and acquired 27,979½ shares at $65.00 per share. In the period from 1968 through 1973, Santa Fe affiliates purchased shares at prices ranging from $65.00 to $92.50 per share. None of the Santa Fe affiliates had acquired any Kirby stock since October 1973. The history of Santa Fe's affiliates' prior purchases provided plaintiffs with another basis of comparison for evaluating the merits of the exchange offer.

The complaint demonstrates merely that the parties to this action differ in their computation of the fair value of plaintiffs' shares. Whatever the information statement indicates about the fair value of plaintiffs' shares, the value of the physical assets "was discernible, as plaintiff[s] discerned it." Tanzer Economic Associates, Inc. v. Haynie, 388 F. Supp. 365, 369 (S.D.N.Y. 1974).

See also, Spiegler v. Wills, 60 F.R.D. 681 (S.D.N.Y. 1973). The inadequacy of the offering price, standing alone, does not demonstrate bad faith or overreaching on the part of the controlling interests. See Muschel v. Western Union Corporation, 310 A.2d 904 (Del.Ch.1973).

In Dreier v. The Music Makers Group, Inc. (1973-74) CCH Fed.Sec.L.Rep ¶ 94,406 (S.D.N.Y. February 20, 1974), a suit alleging a violation of Rule 10b-5 in connection with the merger of a publicly held corporation, The Music Makers Group, Inc., into a privately owned company, Leigh Group, Inc., effectuated by the voting power of Leigh Group, Inc., the majority shareholders of Music Makers Group, Inc., the Court dismissed the amended complaint holding that

> "non-disclosure remains an essential element in any section 10(b)-Rule 10b-5 action. Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972). The instant complaint does not allege any non-disclosure in connection with the merger; the treatment of the minority shareholders may well have been grossly unfair but it was completely open. Under these circumstances plaintiff's remedy is a state court action for appraisal pursuant to the Delaware Corporation Law." *Id.,* at 95,410. *Accord,* Popkin v. Bishop, *supra;* Kaufmann v. Lawrence, 386 F.Supp. 12 (S.D.N.Y.1974)

If adequate disclosure is made, "[u]nderlying questions of the wisdom of [merger freeze-out] transactions or even their fairness become tangential at best to federal regulation." Popkin v. Bishop, *supra,* 464 F.2d 720. See also, Armour and Company v. General Host Corporation, 296 F.Supp. 470 (S.D.N.Y.1969).

It was for each shareholder to determine, on the basis of the information provided, whether the price offered was adequate or whether he should seek a judicial appraisal. The instant complaint fails to allege an omission,

misstatement or fraudulent course of conduct that would have impeded a shareholder's judgment of the value of the offer. *Cf.* Levine v. Biddle Sawyer Corp., 383 F. Supp. 618 (S.D.N.Y.1974).

At least, if full and fair disclosure is made, transactions eliminating minority interests are beyond the purview of Rule 10b-5. Support for this proposition is found in the Securities and Exchange Commission's ("SEC") own estimate of the reach and the limitations of existing regulations in dealing with "going private" transactions. The interpretation propounded "by an agency charged with the administration of a statute, while not conclusive, is entitled to substantial weight." Zeller v. Bogue Electric Manufacturing Corporation, 476 F.2d 795 (2d Cir.), cert. denied, 414 U.S. 908, 94 S.Ct. 217, 38 L.Ed.2d 146 (1973). The SEC has promulgated proposed rules which would subject such transactions to comprehensive regulation. See Proposed Rules 13e-3A and 13e-3B, 2 Fed. Sec.L.Rep. ¶¶ 23,704-05; Securities Act Release No. 5567 (1975), [Current] CCH Fed.Sec.L.Rep. ¶ 80,104. Notably, Proposed Rule 13e-3B(a) would make unlawful a shareholder freezeout transaction unless the transaction has "a valid business purpose" other than getting rid of a minority which might or does impede the will of the majority; and "the terms of [the] transaction, including any consideration to be paid to any security holder, are fair."

Another proposed SEC regulation would require, notwithstanding the provisions of a state's corporate law, that notice of the terms of any freeze-out transaction be sent to shareholders no later than 20 days prior to "authorization" of the transaction. Proposed Rule 13e-3A(c)(1). In addition to other disclosure requirements, both of the proposed rules would require that, for the consideration paid to be deemed fair, it must exceed the value placed on the securities by "two qualified independent persons." Proposed Rule 13e-3A(c)(2).

Implicit in the Commission's expressed intent to enact these or similar rules is the conclusion, which this Court shares, that existing rules, including Rule 10b-5, do not reach the acts here complained of.

Assuming *arguendo* that the merger information statement did not constitute adequate disclosure, the amended complaint does not demonstrate a causal connection between the alleged deception and plaintiffs' damages. Plaintiffs did not tender their shares for cancellation and payment pursuant to this merger plan. On August 1, 1974, the information statement was mailed to the minority shareholders. On August 21, 1974, the plaintiffs made a demand for an appraisal of their shares pursuant to Delaware statute, but, by letter dated September 9, 1974, they purported to withdraw this demand. On September 10, 1974, plaintiffs commenced this action. From the outset, plaintiffs recognized the alleged deception and did not rely upon it.

In a freeze-out merger, reliance need not be shown, Vine v. Beneficial Finance Company, *supra,* 374 F.2d 635; however, there must be some causal connection between the wrong done and the harm suffered. See Schlick v. Penn-Dixie Cement Corporation, 507 F.2d 374 (2d Cir. 1974); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974). In *Vine, supra,* although finding that no misrepresentation was made to the minority shareholders in a short-form merger, and that, therefore, there could be no reliance in the traditional sense, the Court found an actionable 10b-5 claim on the basis of misrepresentations made in the course of the parent company's acquisition of the shares needed to effect the short-form merger. See also, Voege v. American Sumatra Tobacco Corporation, 241 F.Supp. 369 (D.Del. 1965). No allegation is made here that the Santa Fe affiliates acquired their dominant interest by means of a fraud. In sum, the instant complaint fails to satisfy even the relaxed standard

of causation which must be shown to sustain an action as a "forced seller" under Rule 10b-5.

In finding that there is no causal connection, it may be added that the Court is not applying a standard of "but for" causation and does not view the Santa Fe affiliates as being immune from suit merely because the resulting merger could be effectuated without any action by the minority. See Swanson v. American Consumer Industries, Inc., 415 F.2d 1326 (7th Cir. 1969); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 385, n. 7, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970); *cf.* Kraficisn v. LaSalle Madison Hotel Co., (1972-73) CCH Fed.Sec.L.Rep. ¶ 93,586 (N.D.Ill. 1972). Rather, the Court finds that these plaintiffs in their complaint fail to allege that they relied to their detriment on the alleged misrepresentation and were injured thereby.

For the foregoing reasons, it appears that the amended complaint fails to state a claim under the federal securities laws. Since the complaint fails to state a federal claim, exercise of pendent jurisdiction to adjudicate common law claims of breach of fiduciary duty is inappropriate. Kavit v. A. L. Stamm & Co., 491 F.2d 1176 (2d Cir. 1974).

Diversity jurisdiction will not lie in the absence of complete diversity of citizenship between all parties plaintiff and all parties defendant. Strawbridge v. Curtiss, 3 Cranch 267, 2 L.Ed. 435 (U.S. 1806). The amended complaint states (¶ 1) that there is no diversity of citizenship between the plaintiffs and defendant Morgan, Stanley.

Plaintiffs lack standing to maintain this action derivatively in the right of Old Kirby. Under Delaware law, as a result of a merger, the derivative rights of the merged subsidiary pass to the surviving corporation. Bokat v. Getty Oil Co., 262 A.2d 246 (Del.Sup.Ct. 1970); Braasch v. Goldschmidt, 41 Del. Ch. 519, 199 A.2d 760 (Del. Ch. 1964); Heit v. Tenneco, Inc., 319 F.Supp. 884 (D.Del.

1970). See also, Voege v. Ackerman, 364 F.Supp. 72 (S.D.N.Y. 1973). Assuming however, that the plaintiffs retain their rights as shareholders of Old Kirby after the merger, a derivative recovery would be an inappropriate remedy. If plaintiffs were to be successful on their derivative claims, the benefits would enure either to a corporation that is no longer functioning or to the entire class of Kirby shareholders, including the Santa Fe affiliates who are the purported malefactors. Vine v. Beneficial Finance Company, *supra,* 374 F.2d 637; de Haas v. Empire Petroleum Company, 300 F.Supp. 834 (D.Colo. 1969). See also, Johnson v. American General Insurance Company, 296 F. Supp. 802 (D.D.C. 1969).

This complaint has been amended once. Plaintiffs on the oral argument of this motion show no facts or contentions which they could assert if given further leave to serve a second amended complaint. In the absence of any such showing, this motion is granted, and the amended complaint is dismissed.

So ordered.

Appendix C—Opinion of the Court of Appeals.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 157—September Term, 1975.

(Argued November 5, 1975 Decided February 18, 1976.)

Docket No. 75-7256

S. WILLIAM GREEN, EVELYN GREEN and CYNTHIA COLIN, as Executors of the Estate of Louis A. Green, deceased, and EVELYN GREEN, individually, and as stockholders of KIRBY LUMBER CORPORATION, suing on behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs-Appellants,

—against—

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC., KIRBY LUMBER CORPORATION, and MORGAN STANLEY & CO.,

Defendants-Appellees.

Before:

MEDINA, MOORE and MANSFIELD,

Circuit Judges.

Appeal from an order and judgment of the United States District Court for the Southern District of New York, Charles L. Brieant, Jr., *Judge.*

S. William Green and others, shareholders of Kirby Lumber Corporation, appeal from an order and judgment

dismissing their complaint for failure to allege subject matter jurisdiction and for failure to state a claim for relief. Opinion below, 391 F.Supp. 819. Affirmed as to defendant Morgan Stanley & Co., reversed as to the other defendants.

AARON LEWITTES, New York, N.Y. (Sidney Bender and Leventritt Lewittes & Bender, New York, N.Y., on the brief), *for Plaintiffs-Appellants.*

WILLIAM R. GLENDON, New York, N.Y. (Guy C. Quinlan, Gene M. Bauer and Rogers & Wells, New York, N.Y., on the brief), *for Defendants-Appellees Santa Fe Industries, Inc., Santa Fe Natural Resources, Inc., and Kirby Lumber Corporation.*

S. HAZARD GILLESPIE, New York, N.Y. (James W. B. Benkard, Charles R. Morgan and Davis, Polk & Wardwell, New York, N.Y., on the brief), *for Defendant-Appellee Morgan Stanley & Co.*

MEDINA, *Circuit Judge:*

S. William Green and others, shareholders of Kirby Lumber Corporation, individually and as such shareholders, suing on behalf of themselves and for the benefit of the corporation and for the class of all other minority shareholders of Kirby, appeal from an order of Judge Charles L. Brieant, Jr. in the Southern District of New York, dismissing their amended complaint for failure of subject matter jurisdiction and for failure to state a claim on which relief can be granted. The opinion below is reported at 391 F.Supp. 849.

This important, interesting and complicated case involves a claim, framed in a double aspect, by minority shareholders and the class they represent arising out of S.E.C. Rule 10b-5 concerning the purchase and sale of securities in interstate commerce in the setting of a short-form merger under the laws of the State of Delaware. These laws permit a majority of 90% or more of the shareholders of a Delaware corporation to squeeze out the minority without giving prior notice of the intention to do so, without any statement of a justifiable corporate reason for the merger and upon payment to the minority shareholders of an amount of dollars per share specified in the terms of the merger. The sole remedy of an objecting minority shareholder under these Delaware laws is to demand an appraisal of the value of his stock in a proceeding in the Delaware Court of Chancery.[1]

The double aspect of the claim asserted in the complaint is:

(1) that the Delaware procedure as applied to the facts of this case constitutes a "device, scheme, or artifice to defraud" because of the gross undervaluation by defendants of the shares the minority shareholders are forced to sell for $150 a share; and

(2) that without any misrepresentation or failure to disclose relevant facts, the merger itself constitutes a violation of Rule 10b-5 because the mulcting of the minority shareholders is accomplished by a breach by the majority

[1] While the appraisal statute, Del. Code Ann. tit. 8 § 262 (1974) is silent on the exclusivity of the appraisal remedy, it is generally held exclusive as against one who complains of a short-form merger. See *Abelow* v. *Midstates Oil Corp.*, 41 Del. Ch. 145, 151, 189 A.2d 675, 679 (Sup. Ct. 1963); *Stauffer* v. *Standard Brands Inc.*, 41 Del. Ch. 7, 9-10, 187 A.2d 78, 80 (Sup. Ct. 1962). But see *Braasch* v. *Goldschmidt*, 41 Del. Ch. 519, 524, 199 A.2d 760, 764 (Ch. 1964).

of its fiduciary duty to deal fairly with the minority who in effect are the *cestuis* of the majority. This breach of fiduciary duty is the forcing of the minority to sell their stock at far less than it is worth against their will, and even without any opportunity to seek pre-merger relief from the courts, all for the enrichment of the majority who continue to hold their stock. All this is alleged to be done at the expense of the corporation without any corporate purpose justifying the expenditure.

Jurisdiction is based upon Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. Section 78aa, and exists only if the amended complaint contains allegations that on their face make out a case of fraud within the meaning of Section 10(b), 15 U.S.C. Section 78j(b) and S.E.C. Rule 10b-5, 17 C.F.R. 240.10b-5. We do not reach the pendent and diversity claims.

The judge and counsel for all parties wisely agreed, for the purposes of the motion to dismiss, to consider the entire Information Statement, including the letter of Morgan Stanley & Co. of June 24, 1974, and all the annexed Exhibits, Schedules and Appraisals, as part of the amended complaint. They also agreed to treat the allegation that the purpose of the merger was to freeze out the minority shareholders as a charge that this was not done for any justifiable corporate purpose. The subject is discussed on this basis in the opinion below. We would not have mentioned this subject had it not been for the fact that the defendants in a footnote on page 9 of their main brief make a halfhearted claim that by not mentioning the lack of business purpose in their main brief the appellants had "abandoned this position." We find no abandonment whatever of this very significant part of plaintiffs' claims. Appellants may have given this phase of their contentions less emphasis in order to keep Morgan Stanley & Co. in the case.

I

We do not write on a clean slate. The background of judicial decisions is truly formidable, especially as the opinions contain so many dicta that may be thought by some to be ambiguous and so many seemingly unnecessary digressions. Accordingly, we think it will be helpful to an understanding of this opinion as a whole if we refer at the outset, and before our outline of the facts, to the holdings of this Court on two of the law points crucial to the disposition of this appeal.

First. It seems to be thought that it is a complete defense to show that defendants did exactly what the laws of Delaware required in order to effecuate a short-form merger. Under Delaware law the sole remedy of the dissenting minority shareholders is the Delaware appraisal proceeding.[2] But it is settled law in the Second Circuit that "Where Rule 10b-5 properly extends it will be applied regardless of any cause of action that may exist under state law." *Popkin* v. *Bishop,* 464 F.2d 714, 718 (2d Cir. 1972). *See also Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 635-36 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967); *Levine* v. *Biddle Sawyer Corp.,* 383 F.Supp. 618, 622 (S.D.N.Y. 1974). So, here, the principal if not the sole question we have to decide is whether or not plaintiffs have stated a claim arising out of Rule 10b-5. The legal reasoning supporting this holding is, we think, that the states have no power to preempt Congress in the creation of substantive rights and remedies arising from purchases and sales of securities in interstate commerce. Neither Delaware nor any other state may do more than create substantive remedies that are not preemptive or exclusive but must compete with other properly constituted remedies

[2] *See* note 1 *supra.*

in the market place where the most effective and least costly of those procedures may be expected to prevail. The remedies available to redress violations under the Securities Exchange Act are supplementary to those provided by the states and they may not be abrogated merely by the coincidental availablity of an alternate or corollary state remedy. Furthermore, the fact that a state has chosen to create a particular remedy for a particular injury in no way precludes the Congress from creating an additional form of relief for another injury. Thus, the fact that a shareholder claiming fraud both in the consummation of a merger not based on any justifiable corporate purpose and in the undervaluation of his shares may under state law only resort to an appraisal proceeding that merely ameliorates the undervaluation does not foreclose the right of the Congress and the federal courts to provide that claimant an additional right and remedy to redress any injury flowing from a fraud inherent in the merger itself.

Second. Another erroneous assumption is that in order to allege a claim under Rule 10b-5 there must be some showing of misrepresentation or lack of disclosure. This, is one of the grounds stated by Judge Brieant in the court below for his dismissal of the complaint. 391 F.Supp. 849, 854-55. But only subdivision (2) of 10b-5 deals with nondisclosure and misrepresentation. The Rule contains two other subdivisions which state explicitly that fraud other than and in addition to a failure to disclose or truthfully represent is also actionable:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

* * *

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

It must be that the failure to observe this broader scope of Rule 10b-5 led the court below to dismiss the complaint, even accepting "plaintiffs' claimed valuation" and assuming the truth of the allegations of the complaint to the effect that the stock was grossly undervalued and that there was no justifiable corporate reason for the merger. Our later review of the decisions of this Court on the subject of allegations under Rule 10b-5 of breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure will, we think, demonstrate that in such cases misrepresentation or lack of disclosure are not essential ingredients of the claim for relief by the minority. But, lest there be any lingering doubt on this point, we now hold that in such cases, including the one now before us, no allegation or proof of misrepresentation or nondisclosure is necessary.

As with other laws Rule 10b-5 must be interpreted and applied so as to accomplish the purpose for which it was intended. That this requires a generous reading is too obvious for comment. Since the time to which the memory of man runneth not to the contrary the human animal has been full of cunning and guile. Many of the schemes and artifices have been so sophisticated as almost to defy belief. But the ordinary run of those willing and able to take unfair advantage of others are mere apprentices in the art

when compared with the manipulations thought up by those connected in one way or another with transactions in securities. This is especially true of schemes that seem to be absolutely safe but offer rich rewards. In these days when there are takeovers and tender offers galore, times when those who used to think of going public now think of becoming private again, it is especially important to give Rule 10b-5 its full scope. If this is to be done, the enforcement of the fiduciary duty owed by the majority to the minority in corporations large and small should not be overlooked.

At this stage of the proceedings in this case we need not concern ourselves with the federal rules to be formulated relative to the ascertainment of the true value of the shares now held by the minority nor the specific remedy to be applied should the plaintiffs prevail.

We also recognize that we are only dealing now with the allegations of the complaint, which we must assume to be true. The defendants may prove that there has been no breach of fiduciary duty by the majority. More of this later.

Without further discussion we think it is clear that the case relates to the purchase and sale of securities in interstate commerce,[3] that the plaintiffs are indeed forced sellers,[4] and that there is a causal relation between the alleged breach of fiduciary duty by the majority and the injury suffered by the complaining owners of the minority stock interest.

II

Prior to July 31, 1974, plaintiffs were minority shareholders of Kirby Lumber Co., a Delaware corporation. For

[3] *Vine* v. *Beneficial Finance Co.*, 374 F.2d 627, 634 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); *Popkin* v. *Bishop*, 464 F.2d 714, 718 n. 8 (2d Cir. 1972).

[4] *Vine* v. *Beneficial Finance Co.*, *supra*, at 635.

some years prior to the merger transactions involved here, approximately 95% of the capital stock of Kirby was owned by defendant Santa Fe Natural Resources ("Resources") which in turn is a wholly-owned subsidiary of defendant Santa Fe Industries, Inc. ("Santa Fe").

In July, 1974, Resources embarked upon a plan to effect a short-form merger pursuant to Section 253 of the Delaware Corporation Law, which permits a parent corporation owning at least 90% of the capital stock of a subsidiary to merge the parent and the subsidiary, upon approval by the parent's Board of Directors and shareholders. Accordingly, a fourth corporation, Forest Products, Inc. ("Forest Products"), was organized in July as a Delaware corporation. Resources transferred approximately 95% of the capital stock to Forest Products, together with cash and the assumption of certain liabilities, in exchange for all of Forest Product's capital stock.

Shortly thereafter, the board of Forest Products adopted a Section 253 merger resolution providing that Forest Products would be merged into Kirby, with Kirby as the surviving corporation. Since such a merger resolution may provide that all shares held by minority shareholders will be purchased for cash, and consent of the minority shareholders is not required, the resolution stipulated that the minority shareholders of Kirby would have the right to receive $150 per share or to seek appraisal for their stock, as permitted by the Delaware statute. The merger became effective on July 31, 1974. In accord with Delaware Corporation Law Section 253(b), "new" Kirby notified the shareholders of "old" Kirby of the merger and of their rights, and sent a detailed financial Information Statement regarding Kirby.

None of the plaintiffs tendered any of the stock of Kirby. Instead, on August 21, 1974, they made a demand for appraisal of their Kirby stock. On September

9 of that same year, however, they purported to withdraw that demand, and on September 10, they commenced this lawsuit.

The gravamen of their complaint, in which the prayer for relief is that the merger be rescinded, that plaintiffs be awarded money damages or such other and further relief as may be just, is that the short-form merger resulted in the acquisition of the minority shares at a "grossly undervalued price." That undervaluation, they claim, combined with the corporation's failure to disclose the merger to plaintiffs until after its completion, and the fact that, as they say, the merger was effected without any business purpose, constituted a manipulative and deceptive device in breach of Rule 10b-5 and a common law breach of the fiduciary duty owed to Kirby and its minority shareholders. Since an opinion from Appraisal Associates, contained in the Information Statement sent to plaintiffs, valued Kirby's land and timber at $320 million, plaintiffs contend that the appraisal of the minority shares should have been at least equal to $772 per share. The statement to the minority shareholders presented the alternative of cash amounting to $150 per share or a valuation by the courts if requested. The $150 per share was based upon the opinion of Morgan Stanley & Co. which concluded:

> Based on our studies as outlined above, and on the assumptions that (i) the shares of Kirby were broadly distributed and freely traded such that willing buyers and willing sellers could readily effect transactions and (ii) the shares were split so that they would trade within the range of prices typical for many publicly-held companies, we are of the opinion that, under current market conditions, the price at which Kirby stock would trade would be the equivalent of $125 a share.

This opinion was expressed in a letter of June 24, 1974, which in turn was based upon a detailed study of the business affairs of Kirby Lumber Corporation, including a review of financial statements and appraisals of the Company's properties as set forth in elaborate schedules attached to the Information Statement. All plaintiffs' claims with respect to the alleged "fraudulent" and "unconscionable" undervaluation of the stock are based upon what was thus disclosed to the shareholders prior to the merger in the Information Statement.

III

The Law

A

The Delaware Corporation Laws

Many years ago the State of Delaware through its legislature established a series of corporation laws thought to be favorable to corporate management and designed to attract corporations to the state for the purpose, among others, of raising revenue for the state and furnishing business for the members of the legal profession located in Delaware. Many of these laws were copied in other states for similar purposes. Without making a long story of it, some of these laws were intended to facilitate the squeezing out of minority shareholders. Of these laws, the one with which we are principally concerned here made elaborate provisions for a short-form merger under Section 253 of the Delaware Corporation Law. The salient feature of this short-form merger was that a majority of 90% of the shareholders could eliminate the 10% minority without any vote of the shareholders, without prior notice to the minority shareholders, without any statement of corporate purpose and by fixing an amount to be paid

per share to the minority shareholders, who were given the option of selling their shares at the stipulated price or demanding an appraisal under the auspices of the Delaware Court of Chancery, pursuant to the terms of Section 262 of the Delaware Corporation Law. We are told that the avowed purpose of these laws was to wipe out the minority.[5] The Delaware courts have held that the sole remedy of the minority shareholders is to demand the appraisal and be paid the amount per share fixed by the appraisal.[6] No opportunity is afforded the minority shareholder in advance of the date when the merger becomes effective to apply to any court for injunctive relief to stop the merger, nor is there any provision for rescission or other relief.

The Delaware laws also permit a long-form merger in cases where the majority have control but not 90% of the stock. In such cases prior notice is required and an opportunity is afforded to apply to a court for injunctive relief. In this class of mergers a vote of the shareholders is necessary.

In the case of a short-form merger, if the majority decides to fix the price to be paid to the minority shareholders at a figure substantially less than the shares are worth and the merger becomes effective and the minority shareholders turn in their stock and receive from the corporation the amount stipulated to be paid, all in the absence of any stated corporate purpose, the corporation pays for the stock bought from the minority shareholders, the minority shareholders are squeezed out and the entire benefit of the transaction inures to the majority shareholders. The corporation receives no advantage, and may in

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[5] See *Stauffer* v. *Standard Brands Inc.*, 40 Del. Ch. 202, 178 A.2d 311, 314 (Ch. 1962), *aff'd*, 41 Del. Ch. 7, 187 A.2d 78 (Sup. Ct. 1962).

[6] See note 1 *supra*.

fact suffer detriment, and by the elimination of the shares of stock of the minority the majority's shares become more valuable. Plaintiffs claim this is just such a case.

B

Where a Breach of Fiduciary Duty by Majority Shareholders with Resulting Detriment to the Minority Is Alleged as in this Case, No Claim of Misrepresentation or Lack of Disclosure Is Required to Make Out a Case Under Rule 10b-5

The main thrust of the decision below is that to state a preliminary case under Rule 10b-5 there must be misrepresentation or lack of disclosure even in the pressence of a breach of fiduciary duty. We disagree. While the "fraud" at which 10b-5 is aimed obviously includes the classic examples of misrepresentation and nondisclosure inveighed against in *Ruckle* v. *Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964) and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), it is by no means limited to that type of illegality. As the Court stated in *S.E.C.* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963), quoting from *Moore* v. *Crawford*, 130 U.S. 122, 128 (1888):

> Fraud, indeed, in the sense of a court of equity properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another.

The Court has previously made clear that Section 10(b) was not intended to be a panacea for all corporate ills and management wrongdoing, *Superintendent of Ins.* v. *Bankers Life and Casualty Co.*, 404 U.S. 6, 11-12 (1971). But it has also directed that "[s]ection 10(b) must be read

flexibly, not technically and restrictively." *Id.*, at 12. *See also A.T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 396-7 (2d Cir. 1967). We have followed that mandate.

In *Schoenbaum* v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968) (*en banc*), *cert. denied sub nom. Manley* v. *Schoenbaum*, 395 U.S. 906 (1969), we focused on the question whether improper self-dealing and breach of fiduciary duty by the majority, without more, constituted a violation of 10b-5. Answering that question in the affirmative, Judge Hays, writing for the majority, emphasized subdivision (3) of 10b-5 and held that a preliminary cause of action under that Rule had been stated. Breach of fiduciary duty and fraud on the *cestuis* and the corporation had been committed, on the facts as alleged, when Banff sold its shares to Aquitaine at an inordinately low price after the directors had learned of the important oil discovery and before that information had been made public, even though there had been neither misrepresentation nor failure to make any required disclosure to the minority. The decision echoes the well-established principles enunciated in *Pepper* v. *Litton*, 308 U.S. 295, 306-7 (1939), that directors and controlling shareholders are fiduciaries.

> Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.

Id., at 306. When controlling shareholders of a publicly held corporation use corporate funds to force extinction of the minority shareholders' interest for the sole purpose of feeding the pocketbooks of the controlling shareholders, such conduct goes beyond mere negligent mismanagement

and is properly cognizable as "an act, practice, or course of business which operates or would operate as a fraud * * *." The majority has abused its equitable powers by exercising them for the "aggrandizement, preference, or advantage of the fiduciary to the exclusion of the *cestuis*." *Pepper* v. *Litton*, *supra*, at 311. *See also Drachman* v. *Harvey*, 453 F.2d 722, 736 (2d Cir. 1972) (*en banc*).

Our finding of fraud inherent in the freezing out of a splinter interest in the context of a "going private" transaction that lacks corporate purpose is not without scholarly or judicial support. *See, e.g.*, *Bryan* v. *Brock & Blevins Co., Inc.*, 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974); *Voege* v. *American Sumatra Tobacco Corp.*, 241 F.Supp. 369, 375 (D. Del. 1965) ("Plaintiff at bar was the subject of deception for when she acquired her stock she did so upon the justifiable assumption that any merger would deal with her fairly, only later to find, according to the complaint, that the terms of the merger were designed to defraud her."); Borden, *Going Private—Old Tort, New York, or No Tort?* 49 N.Y.U. L. Rev. 987 (1974); Note, *Going Private*, 84 Yale L. J. 903 (1975); Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 Harv. L. Rev. 1189 (1964).

Most recently in *Marshel* v. *AFW Fabric Corp.*, —— F.2d ——, Dkt. No. 75-7404 (2d Cir. February 13, 1976), we were faced with the question whether a merger lacking any justifiable corporate purpose and effected under the New York long-form merger statute might be challenged by minority shareholders under Rule 10b-5. Notwithstanding the absence of any allegation of misrepresentation or nondisclosure, we granted the shareholders' motion for a preliminary injunction against the proposed merger and held that a cause of action under Section 10(b) and Rule 10b-5 is stated "when controlling stockholders and directors of a publicly held corporation cause it to ex[illegible]orporate funds, to force elimination of minority stoc[illegible]ers' equity participation for reasons not benefiting the corporation but rather serving only the interests of the controlling stockholders * * *." Like the Delaware provisions, the New York merger statutes provide an appraisal remedy for the complaining minority shareholders. In addition, however, since prior shareholder approval is required in the instance of the long-form merger, the shareholders in *Marshel* were also afforded the opportunity to seek premerger injunctive relief. We regard the unavailability of this additional remedy in the case before us as further justification for the intervention of the federal courts to remedy any fraudulent conduct.

We hold that a complaint alleges a claim under Rule 10b-5 when it charges, in connection with a Delaware short-form merger, that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose. The minority shareholders are given no prior notice of the merger, thus having no opportunity to apply for injunctive relief, and the proposed price to be paid is substantially lower than the appraised value reflected in the Information Statement. We do not hold that the charge of excessively low valuation by itself satisfies the requirements of Rule 10b-5 because that is not the case before us.

C

Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972) Is Distinguishable and the Ruling in that Case Impliedly Supports Our Decision in this Case

Curiously enough both sides in the case before us rely upon *Popkin* as controlling. That was a long-form merger

case under the New York counterpart of the Delaware long-form merger law. There was no basis for a short-form merger as the majority control was 51.7%, far less than the 90% required for a short-form merger. Accordingly, prior shareholder approval of the merger was required and the minority interest was given an opportunity, prior to the consummation of the merger, to sue for injunctive relief to stop the merger. There was no showing of misrepresentation or lack of disclosure and, accordingly, the complaint was dismissed. The principal feature of *Popkin* that distinguishes it from the case before us is that in *Popkin* there was a corporate business purpose so strong as to be as a practical matter compelling. This purpose arose from a stipulation made in a prior New York state suit one of the principal terms of which was that the merger be consummated, evidently for the purpose of avoiding the possibility of future management misconduct. (464 F.2d at 716). Thus the court held that plaintiffs in *Popkin* had no Rule 10b-5 claim.

The reasoning of *Popkin* also supports the conclusion we reach here to the effect that the allegation of breach of fiduciary duty owing by the majority to the minority states a 10b-5 violation without a showing of misrepresentation or lack of disclosure. *Popkin* holds that the primary reason misrepresentation or lack of disclosure was required was that shareholder approval was necessary. "In the context of such transactions [*i.e.,* those for which shareholder approval is required], if federal law insures that shareholder approval is fairly sought and fully given, the principal federal interest is at an end." 464 F.2d at 720 [material supplied]. The plain implication is that in cases such as the short-form merger, where no shareholder approval is required, there is no need for a showing of misrepresentation or lack of disclosure to make out a 10b-5 case. As the *Popkin* court stated,

> In many, if not most, corporate self-dealing transactions touching securities, state law does not demand prior shareholder approval. In those situations, it makes sense to concentrate on the impropriety of the conduct itself rather than on the "failure to disclose" it because full and fair disclosure in a real sense will rarely occur.

464 F.2d at 719. Whether full disclosure has been made is not the crucial inquiry since it is the merger and the undervaluation which constitute the fraud, and not whether or not the majority determines to lay bare their real motives. If there is no valid corporate purpose for the merger, then even the most brazen disclosure of that fact to the minority shareholders in no way mitigates the fraudulent conduct. This is the substance of plaintiffs' reliance on *Popkin* here, and we agree.

It may well be that, in view of the fact that the majority's 51.7% control made it inevitable that minority opposition would be futile, any requirement of misrepresentation or lack of disclosure was illusory. Whether or not this criticism of *Popkin* is justified is, we think, for another day.

IV

The Allegations of the Amended Complaint Fail to State a Claim under Rule 10b-5 Against Morgan Stanley & Co.[7]

As we have already said, we do not now hold that an allegation of substantial undervaluation, standing alone, makes out a Rule 10b-5 case in a Delaware short-form

[7] Of course, the separate position of Morgan Stanley & Co. was not even discussed by Judge Brieant in his opinion as he held that no Rule 10b-5 case had been alleged against any of the defendants because of the absence of any allegation of misrepresentation or lack of disclosure.

merger setting. We deal here with the additional elements of lack of a justifiable corporate purpose for the merger and the fact that the Delaware law provides for no prior notice to the minority shareholders thus depriving them of the opportunity to apply for injunctive relief, as well as the allegations of undervaluation. Morgan Stanley & Co.'s involvement in the merger was strictly limited to the valuation of stock and to the compilation of a report detailing the company's financial status. There is no allegation that Morgan Stanley & Co. engaged in any misrepresentation or nondisclosure such as would support its liability under Rule 10b-5(2).

We find no intimation in the amended complaint or in any of the briefs that Morgan Stanley & Co. had anything whatever to do with the planning of the merger or that it had any knowledge as to whether or not there existed a justifiable corporate purpose for the merger. And, of course, Morgan Stanley & Co. cannot be, and has not been, charged with any responsibility for effectuating the procedural steps incidental to the merger or for implementing the Delaware law and its provision for shareholder notice only after the merger has become effective. Most importantly, Morgan Stanley & Co. has not been charged with participation in the majority shareholders' breach of fiduciary duty, a key element of the latter's 10b-5 liability.

Even with respect to the alleged undervaluation of the stock we think the conclusory allegations that Morgan Stanley & Co. acted willfully, as an accessory and as an aider and abettor in setting the value of the Kirby shares are plainly insufficient. The Information Statement itself, including the Morgan Stanley letter of June 24, 1974, and the Schedules and Exhibits attached to these documents, shows on its face that there was no wilful or other representation by Morgan Stanley & Co. that the Kirby shares should be valued at $150. All that Morgan Stanley & Co.

did, or was asked to do, was to assemble and present for the consideration of the Kirby management and the minority shareholders the data and information, including the price at which the shares would probably be publicly or privately traded, which would enable the minority shareholders to make an intelligent decision as to whether to surrender their stock in return for $150 a share or apply to the Delaware Court of Chancery for an independent valuation of the stock. It is not even alleged that Morgan Stanley & Co. had anything to do with the decision by the majority shareholders to fix the offering price at $150 a share, thereby adding an increment of $25 to the fair market value as appraised by Morgan Stanley & Co., perhaps in the interest of leading the minority shareholders to believe that the offer was a generous one. Finally, it is not alleged that Morgan Stanley & Co. received any benefit or unjustly profited in any direct or indirect manner by its appraisal.

A copy of the letter of Morgan Stanley & Co. of June 24, 1974, is set forth in the margin.[8] We think the refer-

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[8] Morgan Stanley & Co.
1251 Avenue of the Americas
New York, N.Y. 10020

June 24, 1974

Mr. John C. Davis
Vice President
Santa Fe Industries, Inc.
224 South Michigan Avenue
Chicago, Illinois 60604

Dear Mr. Davis:

You have asked that we furnish an opinion as to the present fair market value of a share of capital stock of Kirby Lumber Corporation ("Kirby" or the "Company"), a subsidiary of Sante Fe Natural Resources, Inc. We understand that 25,324.5 shares or approximately 5.1% of the Company's outstanding capital stock constitutes the minority interest.

In connection with our study of the Company for purposes of making our valuation, we have toured the Company's facilities and have had discussions with management regarding the

ence to "fair market value" in the first paragraph as well as the entire last paragraph of the letter is to current sales of shares of Kirby stock on some stock exchange, or otherwise, a subject in which the minority shareholders might be expected to be interested. The record is barren of any information on the subject of public or private trading in shares of this publicly owned stock. Nor do any dates of purchase and sale transactions appear in the record, except certain purchases by affiliates at prices ranging from \$65 per share in 1968 to \$90 per share in 1973 in one of the Exhibits attached to the Information Statement. We are inclined to suspect, in the absence of any statement on this point in the complaint or in the briefs, that the reason

Company's business. We have been furnished with and have reviewed the Company's audited financial statements for the five years ended December 31, 1973, and the unaudited financial statements for the four-month period ending April 30, 1974. We have reviewed the Company's five-year forecast for the years 1974-1978 and have discussed it and the general future outlook for the Company with its management. Also, we have reviewed the written appraisals of the Company's properties and mineral rights which were separately performed by Appraisal Associates and Riggs and Associates.

We have studied the Company's financial position and its operating history and have made comparisons of such information with the financial position and operating histories of other companies in the forest products industry, the securities of which are publicly held and actively traded.

We have, in addition, considered such other matters and made such other studies as we considered necessary or pertinent.

Based on our studies as outlined above, and on the assumption that (i) the shares of Kirby were broadly distributed and freely traded such that willing buyers and willing sellers could readily effect transactions and (ii) the shares were split so that they would trade within the range of prices typical for many publicly-held companies, we are of the opinion that, under current market conditions, the price at which Kirby stock would trade would be the equivalent of \$125 a share.

Very truly yours,

/s/ Morgan Stanley & Co.

for the estimate by Morgan Stanley & Co. was that there was no public or private market for the stock.

Thus, absent any claim that Morgan Stanley & Co. was in any way involved in planning or effectuating the merger, or that it shared in the alleged profiteering and faithless conduct of the majority shareholders, appellants' summary allegations that the Company participated in fraudulently undervaluing the minority shares fails to state a claim under Rule 10b-5.

V

Conclusion

The provisions of the Delaware corporation law relative to short-form mergers have been the subject of favorable and unfavorable comment for years. One of the Commissioners of the SEC has made a speech on the subject. The SEC has circulated certain proposed new rules.[9] Law professors, practicing lawyers and student editors of law reviews have had their say. We do not think it would be profitable to comment on any of this, except to say that we have read all this material and given it the consideration we think it deserves.

We have also refrained from comment on the remedy to be applied, in the event that plaintiffs succeed at the trial, or on the thorny subject of how in such event a proper valuation of the stock is to be made. These are questions proper for consideration at the trial level, after all the

[9] Proposed Rules 13e-3A and 13e-3B, 2 Fed.Sec.L.Rep. ¶¶ 23,704-05; Securities Act Release No. 5567 (1975), [Current] CCH Fed.Sec.L.Rep. ¶ 80,104. The proposed rules would subject short-form mergers and other share repurchase transactions to comprehensive regulation. Significantly, the rules would require that the issuer have a valid corporate purpose for any repurchase of minority shares in connection with a short-form merger and that the terms of such a transaction, including any consideration to be paid to the minority shareholders, be fair.

proofs are in. In view of the conclusions at which we have arrived, we do not reach the pendent or diversity claims.

With respect to defendant Morgan Stanley & Co. the order and judgment appealed from are affirmed. As to the other defendants the order and judgment appealed from are reversed.

MANSFIELD, *Circuit Judge* (Concurring):

I concur in Judge Medina's opinion holding that a short-form merger consummated without any legitimate corporate purpose and without any advance notice to the minority public stockholders, resulting in harm to the latter, violates Rule 10b-5. By using the short-form merger device in this fashion the majority commits a wrong that extends beyond mere mismanagement of corporate affairs; the majority also breaches its duty as a fiduciary to deal fairly with the public investors, and, by acting unilaterally and without any advance notice, deprives them of the opportunity to seek relief based on the absence of any legitimate corporate purpose. The resulting merger amounts to a "manipulative or deceptive device or contrivance" which operates as a fraud on public stockholders of the type intended to be proscribed by § 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder. Upon a showing that the merger had no legitimate corporate purpose, the district court should, if feasible, set it aside or, if the merger cannot effectively be voided,[1] award damages representing the difference between the fair buy-out price and the unfair, unilateral buy-out price set by the corporate insiders.[2] Such relief is not barred by the co-availability of state law remedies. *Superintendent of Insurance* v. *Bankers Life & Cas. Co.,* 404 U.S. 6, 12 (1971); *Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 635-36 (2d Cir.), *cert. denied,* 389 U.S. 970 (1967); *Popkin* v. *Bishop,* 464 F.2d 714, 718 (2d Cir. 1972).

Inherent in the act of "going private" through a short-form merger is an enormous potential for abuse of the corporate insiders' fiduciary position with respect to the "frozen out" public shareholders. Essentially, by "going public" when the stock market is flourishing and squeezing out the public shareholders when the market is depressed, the majority is able to manipulate the sale and purchase of stock to its benefit and to the detriment of the public shareholders, depriving the latter involuntarily of their investment in the corporation, see Vorenberg, *Exclusiveness of the Dissenting Shareholder's Appraisal Right,* 77 Harv. L. Rev. 1189 (1964), at a buy-out price unilaterally selected by the insiders, which they have every incentive to fix below the fair value of the public shareholders' interest. Brudney and Chirelstein, *Fair Shares in Corporate Mergers and Takeovers,* 88 Harv. L. Rev. 297, 298 (1974).

The unfairness and conflicts of interests generated by "going-private" mergers have not been lost on the business

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[1] Ordinarily in providing relief a court faces difficulties in setting aside a consummated merger. However, in the case of a short-form merger, the sole functional difference between the pre- and post-merged entities is the absence of the "frozen-out" public shareholders from the latter. Therefore, unless the parties materially and in good faith had relied upon the merger, the court in equity should be able to undo the unlawful effects of the short-form device by restoring the public shareholders to their pro-rata share of ownership.

[2] As Judge Medina notes, for purposes of this appeal we are to assume that the $150 per share offered by Kirby to the public shareholders is inadequate and that the correct buy-out price equals $772 per share, a sum derived by a pro-rata division of Kirby's appraised assets. Should the district court decide that legal and not equitable relief is appropriate here, it, of course, would be required to determine a fair buy-out price, cf. *Knauff* v. *Utah Construction & Mining Co.,* 408 F.2d 958 (10th Cir.), *cert. denied,* 396 U.S. 831 (1969); *Levin* v. *Great Western Sugar Co.,* 406 F.2d 1112 (3d Cir.), *cert. denied,* 396 U.S. 848 (1969), in the same manner as damages ordinarily are ascertained in a Rule 10b-5 action.

community. For example, Dun's Review, January, 1975, at 37, reports:

> "However one looks at it 'going private' is most often a no-win situation for public shareholders. For the buy-out price is almost always a small fraction of what the investor paid for the stock. The price, moreover is determined by a consultant hired by the buyers. The investors have a choice of taking what is offered or holding a stock that is no longer readily marketable. And the insiders have formidable legal devices available to fight investors who refuse the company's offer.
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> * * * * *
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> "Not only are the offering prices in buy-outs far below what they paid, investors claim, they often do not reflect the current financial strength of the company any more than the market price does." *Id.* at 38.

The Wall Street Journal, October 18, 1974, at 1, concurs, stating:

> "[a] move to go private ordinarily creates a conflict of interest . . . [as] controlling shareholders who directly or indirectly finance the move often are buying back their interests at only a fraction of the price at which they originally were sold to the public. . . ."

And Barron's, March 4, 1974, at 3, 13, warns:

> "Generally, it is the low price of the stock, rather than declining earnings which sends firms private. . . . Admittedly, there are times when it appears that stockholders have been had. Indeed, figures indicate that the ones benefiting most from buying back the stock are the people who sold it to the public in the first place."

In conclusion, Business Week, November 2, 1974, at 114, editorializes:

> "[T]here is a distinctly bad smell about a deal that produces a substantial loss for the majority of the shareholders and a fat profit for a tiny minority."

My purpose in referring to these current appraisals of the short-form merger device by those who have observed it in action is not to impugn the motives of the defendants in this case but to emphasize that the problem created by misuse of the short-form merger is not merely one of regulating "transactions which constitute no more than internal corporate mismanagement," *Superintendent of Insurance* v. *Bankers Life & Cas. Co., supra,* 404 U.S. at 12, but one of protecting the public investor against manipulative devices used to deceive him, and the securities market from devices serving to discredit it, which together form the primary functions of the anti-fraud and anti-manipulation provisions of Rule 10b-5. The short-form merger, when used to squeeze out small public investors by forcing them to relinquish their corporate investments at low prices for no purpose other than to benefit the insiders, can accurately be characterized as a "manipulative or deceptive device or contrivance," *id.* at 10, which interferes with the interests of the public shareholders in the most fundamental of ways, by depriving the investor of his very interest in his corporate investment. It also undercuts the broader purpose of "preserving the integrity of the securities markets," *id.* at 12, for a clearer instance of potential abuse of the market processes cannot be found. Commenting on the use of the short-form merger, SEC Commissioner Sommer has stated:

> "What is happening is, in my estimation, serious, unfair, and sometimes disgraceful, a perversion of the

> whole process of public financing, and a course that inevitably is going to make the individual shareholder even more hostile to . . . the securities markets than he already is." ([1974-75] Fed. Sec. L. Rep. ¶ 80,010 at 84,695)

To immunize the short-form merger from the coverage of Rule 10b-5 merely because state law has authorized the device to be used for the purpose of squeezing out the public shareholders without giving them prior notice or an opportunity to obtain injunctive relief would be to ignore the central protective purposes underlying federal securities legislation and to countenance an anomalous result. Those who are most exposed and most vulnerable—the small outside public shareholders who are not privy to the inner workings of the corporate enterprise and who are forced to accept a unilaterally imposed result—would be the least protected. If they are to enjoy the protection intended to be furnished by 10b-5, that rule must not be interpreted in a technical or niggardly fashion.

When we were first called upon more than a decade ago to decide whether certain types of fraudulent corporate practices or devices fell within the proscriptions of Rule 10b-5, our initial tendency was to adhere rather closely to the elements of common law fraud (misrepresentation, reliance, scienter) in interpreting Rule 10b-5. See, e.g., *O'Neill* v. *Maytag*, 339 F.2d 764, 768 (2d Cir. 1964). Moreover we considered it essential that the fraud, to be actionable under the rule, must be intrinsic to the securities transaction itself. See, e.g., *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 430 F.2d 355 (2d Cir. 1970), *aff'g*, 300 F. Supp. 1083 (S.D.N.Y.), *rev'd*, 404 U.S. 6 (1971). Beginning in *A. T. Brod & Co.* v. *Perlow*, 375 F.2d 393 (2d Cir. 1967), and in *Schoenbaum* v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395

U.S. 906 (1969), however, we recognized that the ambit of the term "fraud" as used in 10b-5 must be widened if Congress' objective—protection of the public investor—was to be achieved. Furthermore, since only section (2) of 10b-5 deals with misrepresentation and non-disclosure, a broader definition of fraud would give effect to the prohibitions of sections (1) (employment of "any device, scheme or artifice") and (3) (engaging in "any act, practice or course of business which operates . . . as a fraud"), which disclose a broad intent to prohibit other forms of fraud. Accordingly in *Schoenbaum* we broke new ground to the extent of holding that where there was improper self-dealing and abuse of fiduciary responsibility by majority shareholders, disclosure of material facts to interested insiders would not preclude public stockholders, who were not privy to the scheme, from holding the controlling wrongdoers liable under 10b-5 for treating the public investors unfairly, even though the technical niceties of common law fraud had not been met. See Folk, *Corporation Law Developments*, 56 Va. L. Rev. 755, 806-07 (1970).

The recognition that "fraud" as that term is used in § 10(b) must be interpreted broadly was given further impetus by the Supreme Court's decision in *Superintendent of Insurance* v. *Bankers Life & Casualty Co., supra,* where, in holding that fraud forming the basis of a 10b-5 suit need not be intrinsic to the securities transaction itself, the unanimous Court stated that "Section 10(b) must be read flexibly, not technically or restrictively," 404 U.S. at 12. In line with this philosophy we, in *Drachman* v. *Harvey*, 453 F.2d 722 (2d Cir. 1972) (en banc), reconfirmed the stand taken in *Schoenbaum* and, in a suit by public investors, held corporate directors liable under 10b-5 for their conduct in calling back their corporation's convertible debentures at an excessive price

in order to prevent conversion into common stock, which would have weakened the opportunity of a third party, with whom the directors were in conspiracy, to obtain control of the company. Judge Smith's dissent, later accepted by the court sitting en banc, did not place reliance upon evidence of misrepresentation or non-disclosure, but instead emphasized "that here the directors of Harvey, influenced by a conflict of interest and acting to support Martin's controlling interest," caused "the corporation [to] sustain . . . damage. . . ." This was considered sufficient to allege a Rule 10b-5 violation under the "broad and liberal reading" required by the rule. *Id.* at 735. More recently, in *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 381 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975), in upholding 10b-5 liability we again de-emphasized the importance of alleged misrepresentations as "only one aspect" or "a part" of the illegal scheme that had at its core "market manipulation" and, as here, "a merger on preferential terms. . . ."

Defendants place heavy reliance upon *Popkin* v. *Bishop*, 464 F.2d 714 (2d Cir. 1972), as representing a departure from our steady trend toward an expansive view of the reach of the federal security laws. However, to the extent that *Popkin* is at all relevant to the short-form merger context, it impliedly supports the application of the *Schoenbaum-Drachman* rule to this case.[3] In *Popkin*, unlike the present case, *prior* stockholder approval of the proposed merger was required. Full *advance* disclosure of the relevant facts regarding the merger ex-

[3] For support of this proposition in the literature, see Comment, *Schlick* v. *Penn-Dixie Cement Corp.: Fraudulent Mismanagement Independent of Misrepresentation or Nondisclosure Violates Rule 10b-5*, 63 Calif. L. Rev. 563, 570 (1975); Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Management Cases*, 86 Harv. L. Rev. 1007, 1044 (1973); 47 N.Y.U.L. Rev. 1229, 1230 (1972).

change ratios to the minority stockholders was effective protection because it gave them the opportunity, as Judge Feinberg noted, to seek state court injunctive relief which was purportedly available under Delaware law. *Id.* at 720. Here, in contrast, disclosure *after* the merger has been consummated is virtually the equivalent of no disclosure at all, since it comes too late to enable the minority to invoke state law for protection against an unwarranted squeeze-out. Indeed, it is well recognized that the state post-merger appraisal procedure does not provide an alternative remedy comparable to federal relief.[4]

[4] Under state law the only recourse available to the aggrieved shareholders is to initiate an appraisal proceeding, thereby hoping to be awarded the full value of their lost shares. In light of a variety of factors common to state appraisal laws, it is generally agreed that they provide an unrealistic remedy. See generally, Brudney, *A Note on "Going Private,"* 61 Va. L. Rev. 1019, 1023-25 (1975); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Take Overs*, 88 Harv. L. Rev. 297, 304-07 (1974); Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decision Making*, 57 Calif. L. Rev. 1, 85 (1969); Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 Yale L.J. 223 (1962).

The Delaware statute is typical. The public shareholders are afforded no right to equitable relief under the statute and therefore are totally dependent upon the valuation figure settled upon by the appraiser. *Stauffer* v. *Standard Brands Inc.*, 187 A.2d 78 (1962). Yet in determining the value of the "frozen out" shares, the appraiser may not award the public shareholders any gain resulting from the merger itself or the expectation thereof. Under the terms of the statute, any payment must be "exclusive of any element of value arising from the expectation or accomplishment of the merger or consolidation." Del. Code Ann. tit. 8, § 262(b). This measuring criterion has been interpreted very stringently. For example, an appraiser may not award "an aliquot share in the value of the assets of the merged corporation." *Application of Delaware Racing Assoc.*, 213 A.2d 203, 209 (1965). The appraiser's focus must be entirely retrospective: "The determination must be based upon historical earnings rather than on the basis of prospective earnings." *Francis du Pont* v. *Universal City Studios*, 312 A.2d 344, 348 (Ch. 1973). In short, the controlling shareholders have every incentive to "freeze out" the outsiders since, even if the appraisal procedure functions perfectly, by the terms of the statute the insiders alone capture all of the prospective gains associated with the merger.

Only through liberal interpretation of 10b-5 will the public investor gain the redress intended to be made available to him.

Our conclusion that where there has been self-dealing on the part of corporate insiders proof of misrepresenta-

In addition, procedurally the Delaware appraisal route is far inferior to a federal cause of action in terms of protection for the minority shareholders. For example, unlike a federal class action Delaware explicitly bars those who actually initiate an appraisal from receiving compensation from non-active members of the class of displaced shareholders, even if the latter have expressed their disagreement with the merger terms and have asked to be included in the final recovery. *Raynor* v. *LTV Aerospace Co.*, 317 A.2d 43, 46 (Ch. 1974); *Levin* v. *Midland-Ross Co.*, 194 A.2d 853, 854 (Ch. 1963). The Delaware courts acknowledge that this inevitably creates a free-rider problem, see 317 A.2d at 46, which in turn insures that only a minority shareholder with a large bloc of shares will find it beneficial to seek an appraisal in the first instance. As Dun's Review, January 1975, at 64, notes: The proceeding takes years . . . and the investors do not even collect dividends while the appraisal is in the courts. Unless a shareholder has at least 20,000 shares, most attorneys believe it rarely pays off financially. . . ." Furthermore the statute expressly excludes the costs of attorneys or expert fees from the appraisal recovery. Tit. 8, § 262(h).

Finally, the extent of discovery rights available to displaced investors remains unclear. The statute provides that the appraiser "may" examine any books and records of the corporation in question, § 262(e), but says nothing about the minority shareholders other than to insure them "a reasonable opportunity . . . to submit to him pertinent evidence on the value of the shares," § 262(e). In the past, when "frozen out" shareholders have attempted "to complicate the issue raised" by demanding "proceedings of an adversary nature," they have been repudiated. *Lichtman* v. *Recognition Equipment Inc.*, 295 A.2d 771, 772 (Ch. 1972) (claimant cannot introduce evidence of the value of stock options lost due to the merger). And while the outside shareholders therefore remain heavily dependent upon the corporation for information, Delaware law does not require disclosure of such information to shareholders even after the fact except for notice of the completed merger and a statement of the buy-out price. Tit. 8, § 253(d). As one commentator notes, "[t]he crucial valuation evidence—estimates of future earnings or of salable value of assets —is available to management but rarely to outsiders. Hence, these evidentiary problems which beset an outsider seeking appraisal or challenging for unfairness a merger which was timed by insiders make it a rare case in which he will succeed in establishing a value higher than was offered in the merger, in view of the leeway which courts allow to management's judgment." Brudney, *supra*, at 1024 n.21.

tion or non-disclosure is not a *sine qua non* to the establishment of 10b-5 liability is shared by other Circuits. In *Pappas* v. *Moss*, 393 F.2d 865, 869 (3d Cir. 1968), Judge Seitz held "that where, as here, a board of directors is alleged to have caused their corporation to sell its stock to them and others at a fraudulently low price, a violation of Rule 10b-5 is asserted." The only deception found in the case, two misstatements in the shareholder resolution authorizing the sale, was of no practical consequence to the wrongdoing since shareholder ratification was unnecessary under state law and, in any event, was sought only after the sale was consummated. *Id.* at 867, 869. Similarly, the Fifth Circuit has repeatedly held corporate insiders liable under Rule 10b-5 in the absence of misrepresentation. For example, in *Rekant* v. *Desser*, 425 F.2d 872, 882 (5th Cir. 1970) (Wisdom, *J.*), the court wrote:

> "We conclude, therefore, that when officers and directors have defrauded a corporation by causing it to issue securities for grossly inadequate consideration to themselves or others in league with them or the one controlling them, the corporation has a federal cause of action under § 10(b). . . . The essence of the transaction is not significantly different from fraudulent misrepresentation perpetrated by one individual or another."

Similarly, in *Shell* v. *Hensley*, 430 F.2d 819, 826-27 (5th Cir. 1970) (Ainsworth, *J.*), citing *Schoenbaum*, the court held directors liable for scheming to sell control to another corporation. In response to the argument that there had been no deception of the corporation warranting 10b-5 liability, since the controlling directors had all the relevant information, the court responded that to so construe 10b-5 would be to permit "the basest sort of chicanery" and re-

move the "protection of the section and the rule merely because of the ease with which defendants victimized [the corporation]." See also *Bryan* v. *Brock & Blevins Co.*, 490 F.2d 563, 571 (5th Cir.), *cert. denied,* 419 U.S. 844 (1974); *Travis* v. *Anthes Imperial Ltd.*, 473 F.2d 515, 527 (8th Cir. 1973) (Rule 10b-5 liability found even though "[t]he essence of the plaintiffs' complaint . . . is that the defendants violated § 10(b) and Rule 10b-5 by engaging in self-dealing. . . . Here, as in *Sup't of Insurance,* the defendants' self-dealing was a violation of a fiduciary obligation to minority shareholders. . . .").

Defendants' efforts to reconcile these decisions by searching for some misrepresentation or non-disclosure ignores the court's plain language in each case and exalts form over substance. Such misrepresentations as may be found generally related to technical, trivial matters, having little or no relevance to the manipulative conduct giving rise to 10b-5 liability. Furthermore, in some of the cases the courts, in imposing § 10(b) liability, were quite explicit in acknowledging the absence of misrepresentation or openly minimizing its import to the illegal conduct under challenge.

Thus our decision today is not only consistent with the trend of our own case law on the subject of 10b-5 liability but with the line of authority developing in other Circuits. In holding that a short-form merger which lacks any legitimate corporate purpose may violate 10b-5 we of course do not foreclose use of the device for legitimate corporate purposes. Such a merger, for instance, might lawfully provide an acceptable method of enabling a corporation to achieve substantial savings in operating expenses or to dispose of an unprofitable business at a favorable price. However, where a short-form merger involving use of a dummy corporation appears to be used for no purpose other than to squeeze out minority public shareholders, as is alleged in this case, the burden is upon the corporate in-

siders to demonstrate the existence of a legitimate compelling corporate purpose.

MOORE, *Circuit Judge* (Dissenting):

I most strongly dissent from the use of their powers by two judges of one of the eleven judicial Circuits to override and nullify not only the corporate laws of Delaware with respect to short-form corporate mergers, but also, in effect, comparable laws in an additional thirty-seven States.[1]

By their opinion, the majority has found a fraudulent scheme, and hence a violation of Rule 10b-5 where none exists. They have established an irrebutable presumption that use of the short-form merger law amounts to a fraud

[1] The following States have short-form merger statutes (the percentage of the subsidiary's stock which must be owned by the parent appears in parenthesis after each State):

Nebraska (80%)	Oregon (90%)
• • •	Pennsylvania (90%)
Arkansas (90%)	Rhode Island (90%)
Colorado (90%)	Tennessee (90%)
Connecticut (90%)	Texas (90%)
Delaware (90%)	Utah (90%)
Florida (90%)	Virginia (90%)
Georgia (90%)	West Virginia (90%)
Hawaii (90%)	Wisconsin (90%)
Iowa (90%)	• • •
Kansas (90%)	Indiana (95%)
Kentucky (90%)	Mississippi (95%)
Louisiana (90%)	Montana (95%)
Maine (90%)	New Mexico (95%)
Maryland (90%)	New York (95%)
Massachusetts (90%)	North Dakota (95%)
Michigan (90%)	South Carolina (95%)
Nevada (90%)	Vermont (95%)
New Jersey (90%)	Washington (95%)
Ohio (90%)	• • •

Illinois (99%)

per se. They have added a clause to the Delaware statute —not placed there by the State's legislature—that a short-form merger must have a "justifiable corporate purpose". They have manufactured evil intent and attributed it to individuals who were merely following the lawful edicts of Delaware, to the point of characterizing as "full of cunning and guile", and "so sophisticated as almost to defy belief", corporate actions of the utmost simplicity and patent reasonableness in today's economy and securities market.

My agreement with the majority starts and stops on the first page of its opinion. The case is "important, [and] interesting"; it is not "complicated". Although legal issues are frequently clothed in dark and light shades of gray, the case at bar is a study in the stark contrast of black and white. The majority's conjury in holding that this case presents a violation of Section 10b of the Securities and Exchange Act and Rule 10b-5 promulgated thereunder[2] is totally without factual anchor, and I cannot refrain at the outset from objecting to the fraility of their factual foundation, which is truly of the character of bricks without straw and an omission that warrants immediate correction.

I. The Facts

The facts are not in dispute, and should be stated for the record in their particulars.

The sovereign state of Delaware in its legislative wisdom enacted a statute, which gives to corporations chartered under its laws, the privilege of merging parent and subsidiary under strictly limited circumstances, namely, owner-

[2] Section 10b prohibits only those manipulative or deceptive devices "in contravention of such rules and regulations as the Commission may prescribe". A condition precedent to a violation of Section 10b is therefore the violation of the appropriate SEC rule, namely, 10b-5. *See* n. 4, *infra.*

ship by the parent of at least 90% (here approximately 95%) of the stock of a subsidiary. Delaware General Corporation Law (DCL) § 253. The statute provides for the payment of cash to the minority stockholders or, in the event that any such stockholder is dissatisfied with the cash offer, he may seek an appraisal in the Delaware Court of Chancery to establish the stock's value. DCL §§ 253(d), 262. In any such proceeding the stockholder would be able to adduce whatever proof he might believe to be supportive of his theory of true value.

The statute, referred to as the "short-form" merger proceeding, contains no provision for advance notice of the merger to be given to the minority (10% or less); only approval by the parent's directors and stockholders is required. Notice of the merger, however, has to be given within 10 days of its effective date, and within 50 days thereafter (following an initial demand within 20 days on the surviving corporation) appraisal, if desired, must be sought. DCL § 253(d).

Prior to the merger at issue, some 95% of the stock of Kirby Lumber Corporation (Kirby) was owned by Santa Fe Natural Resources, Inc. (Resources) which in turn is wholly-owned by Santa Fe Industries, Inc. (Santa Fe).

Plaintiffs are in the 5% (approximately) minority group of Kirby.

To take advantage of § 253 of the Delaware Corporation Law another Delaware corporation, Forest Products, Inc. (FPI) was organized which acquired from Resources its Kirby stock (95%) and on July 31, 1974 Kirby and FPI were merged.

Some time prior to the merger (February 19, 1974) defendants[3] had obtained from Appraisal Associates a writ-

[3] Defendants, unless otherwise specified, will refer to the Santa Fe defendants, excluding Morgan Stanley & Co.

ten appraisal of the land (exclusive of minerals), timber, buildings and machinery of Kirby as having a market value of $320,000,000. Such an appraisal of physical assets mathematically would have amounted to a book value of the outstanding shares of Kirby of $722.

Subsequently, defendants, seeking a fair market value appraisal of the Kirby stock as of June 24, 1974, obtained from Morgan Stanley & Co. a stock valuation of $125 per share. This figure was given with knowledge of Appraisal Associates' valuation of Kirby's physical assets of $320,000,000.

After the merger, as provided by Delaware law, DCL § 253(b), namely, "within 10 days after the effective date of the merger", notice of the merger was given to the minority stockholders that they had a right to receive $150 per share in cash or to seek an appraisal of the value of their shares as provided by Delaware law. DCL § 253(d).

Accompanying the notice was a statement (some 57 pages of the Appendix) which, in addition to setting forth extensive financial data, included: (1) the Morgan Stanley stock value based largely upon the price ranges for the Kirby stock freely traded on the market; (2) the Appraisal Associates' appraisal of physical assets of $320,000,000; and (3) an appraisal by Riggs and Associates of Kirby's oil, gas and mineral property interests.

On August 21, 1974 plaintiffs elected to pursue the Delaware law remedy of demanding an appraisal. Thereafter, they changed their minds and on September 9, 1974 withdrew this demand. The next day they filed their complaint in the federal court seeking to bring their claim within Section 10b of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Rule 10b-5, 17 C.F.R. 240, 10b-5. Their original complaint was based primarily on the claim that defendants sought to acquire the minority's stock at a "grossly undervalued price" which constituted in plaintiffs' opinion a "manipulative and deceptive device"

amounting to a violation of Rule 10b-5 and "a breach of fiduciary obligation owed to Kirby and its minority stockholders." (Compl. par. 9) An amended complaint added a claim of diversity jurisdiction over the defendants.

At this point it is essential to underscore what was *not* involved in the merger. There was no failure to comply with state law. There was no failure to disclose by the defendants. On the contrary, all of plaintiffs' assertions of stock value derived from the report circulated by the defendants to the minority shareholders. Similarly, there was no misrepresentation of fact or law made to the minority.

II. Federal Law

The purpose of § 10b of the Act, and Rule 10b-5 promulgated thereunder, is the elimination of fraudulent practices in the securities industry. These are anti-fraud provisions, and the existence of fraud is the key to their application.[4]

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[4] Rule 10b-5, which gives exclusive effect to Section 10b, is entitled "Employment of manipulative and deceptive devices", and declares it to be unlawful for any person,

> "(a) To employ any *device, scheme, or artifice to defraud,*
>
> (b) To *make any untrue statement* of a material fact or to *omit to state a material fact* necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) to engage in any *act, practice, or course of business which operates or would operate as a fraud or deceit* upon any person,
>
> in connection with the purchase or sale of any security." (emphasis added)

Subsection (b) is inapplicable here because no claim is made that there were any untrue statements or omissions in the vast amount of information given to the minority stockholders. Plaintiffs' claims must, therefore, rest upon defendants' use of the Delaware statute as a "device * * * to defraud" (subsection (a)) or an "act * * * which [operated] as a fraud or deceit * * *."

It states the obvious to say that the essence of fraud is deliberate deception or concealment which is calculated to deprive the victim of some right or to obtain, by deceptive means, an impermissible advantage over him.[5] It was to eliminate such deception and concealment that the federal securities laws imposed a duty to disclose on those with inside information. Similarly, it has been to eliminate deception and concealment, *i.e.*, to eliminate *fraud*, that the courts have stringently enforced this duty, imposing liability whenever a defendant fails to disclose his actions, his position, or his knowledge.

The majority cites numerous cases en route to its holding that failure to disclose is no longer a prerequisite for liability under Rule 10b-5—that, in fact, liability under the anti-fraud provisions of 10b-5 will attach in the *complete absence* of any deception or misrepresentation, in short, in the complete absence of fraud altogether. This is an untenable hypothesis, and one which is totally disproved by even a cursory review of the decisions in the area. I propose to review the leading cases in order to dispel at once any rumors that 10b-5 no longer concerns itself with fraud, but instead extends to every corporate transaction viewed with displeasure by the courts.

In 1964 in *Ruckle* v. *Roto Amer. Corp.*, 339 F.2d 24 (2d Cir. 1964), the directors of the corporation approved the issuance of stock to its president for an inadequate consideration. It was alleged that information material to the exercise of informed judgment had been withheld from the directors—a clear instance of fraud.

The same year this Court decided *O'Neill* v. *Maytag*, 339 F.2d 764 (2d Cir. 1964), in which we said: "There can be no serious claim of deceit, withheld information or mis-

[5] *See, e.g., Black's Law Dictionary* (4th Ed. 1951) at 788-789; *Ballentine's Law Dictionary* (3d Ed. 1969) at 496-497.

statement of material fact in this case"; the opinion went on to say that, where a complaint alleges a breach of the general fiduciary duty existing among corporate officers, directors and shareholders, "no cause of action is stated under Rule 10b-5 unless there is an allegation of facts amounting to deception." 339 F.2d at 767, 768

SEC v. *Capital Gains Research Bureau*, 375 U.S. 180 (1964), is cited by the majority but in fact is more supportive of the dissent. *Capital Gains*, it should be noted at the outset, was not a 10b-5 case; it involved the unique duties and responsibility of investment advisors to their clients. The entire case was concerned with non-disclosure —specifically, with the failure of the defendant-investment advisor to apprise his clients of his self-interest in their transactions. The defendant's practice had been to buy a stock shortly before recommending it in a newsletter to his clients, and thereafter to sell it (usually within two weeks of the dissemination of the newsletter). The Supreme Court interpreted his legal and equitable duty *not* as a duty to refrain from trading himself (an act not prohibited by state law) but as a duty to disclose whatever interest he in fact had. It was not the existence of self-interest or of the defendant's action in furtherance thereof which went afoul of federal securities law; it was his *concealment* of those facts.

Three years later this Court decided *Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967). Implicitly acknowledging the validity of short-form mergers,[6] the Court struck down a fraudulent sale

[6] "Thus, once the conditions for a short-form merger had been achieved, appellant's rights in his stock were frozen. *He had and still has only the options of exchanging his stock* for $3.29 a share, pursuant to appellee's offer, *or pursuing his right of appraisal,* which would also result in cash from appellee." 374 F.2d at 634. (emphasis supplied)

of certain stock shares at an inflated price on the ground that the scheme presented "a classic case of deception". 374 F.2d at 635. Ruling on the applicability of the federal securities laws to corporate mergers, the Court held:

> "What must be shown is that there was *deception* which misled the Class A Stockholders. . . ." 374 F.2d at 635. (emphasis supplied)

In 1968 came *Schoenbaum* v. *Firstbrook,* 405 F.2d 215 (2d Cir. 1968), a case much relied upon by appellants, heard by an *en banc* Court. This case in many respects was a counterpart of *SEC* v. *Texas Gulf Sulphur,* 401 F.2d 833 (2d Cir. 1968) (*en banc*). In *Schoenbaum,* Aquitaine, which controlled Banff Oil, had knowledge of an important oil discovery by Banff. Without disclosing this fact, Aquitaine caused Banff to issue to it 500,000 shares of Banff at $1.35 a share. After the public announcement of the discovery, Banff stock sold as high as $18 a share. There was more than sufficient indicia of fraudulent non-disclosure to justify denial of a summary judgment motion.

In 1971 the Supreme Court decided *Supt. of Insurance* v. *Bankers Life and Cas. Co.,* 404 U.S. 6 (1971), on appeal from this Circuit. The fraud there was most flagrant. One Begole and a group agreed to buy for themselves all of Manhattan Casualty Company's stock from Bankers Life for $5,000,000 and conspired with others to pay for the stock, not with their own funds but, once they had obtained the stock, out of Manhattan's own assets. A more fraudulent scheme would be difficult to imagine.

In 1972 came both *Drachman* v. *Harvey,* 453 F.2d 722 (2d Cir. 1972) (*en banc*) and *Popkin* v. *Bishop,* 464 F.2d 714 (2d Cir. 1972). The Court in *Drachman* found that as the result of a conspiracy, whereby the Harveys had sold their controlling interest in Harvey Aluminum to Martin

Marietta at handsome premium for themselves and they had caused Harvey Aluminum to redeem its convertible bonds to preserve Martin Marietta's stock control of Harvery Aluminum, there was fraud within the scope of § 10-b and Rule 10b-5.

Popkin presented a somewhat different situation. It was largely to enjoin a merger on the ground that the exchange ratio of the respective stocks was unfair. This Court reviewed the many cases in this field, noting that "Emphasis on improper self-dealing did not eliminate non-disclosure as a key issue in Rule 10b-5 cases", 464 F.2d at 719, and concluding that "when there has been such disclosure of a merger's terms, it seems unwise to invoke federal injunctive power, particularly since doing so might well encourage resort to the federal courts by any shareholder dissatisfied with a corporate merger". *Id.* at 720. But, even assuming the federal courts are anxious to reach out for this sort of business, to do so at the cost of nullifying the corporate laws of many states respecting mergers of comparatively fractional amounts of outstanding stock should cause some restraint in enacting such judicial legislation.

Other circuits have found conspiracy and deception as basic in bringing cases within the statute and Rule. *See Dasho* v. *Susquehanna Corporation,* 380 F.2d 262 (7th Cir., 1967) and *Shell* v. *Hensley,* 430 F.2d 819 (5th Cir. 1970). And of particular interest because it was decided in a federal court in Delaware is *Voege* v. *American Sumatra Tobacco Corporation,* 241 F.Supp. 369 (U.S.D.C., Delaware, 1965). It, too, was a "merger" case. On the merger, $17 a share was offered; the plaintiff refused the offer and demanded an appraisal but, in so doing, did not know that as part of the merger it was planned to sell off a part of *Sumatra's* physical assets (land) which would alone bring in more than $17 a share. The Court, noting that the de-

fendants—for purposes of their motion to dismiss—conceded that their misleading statements amounted to a scheme to defraud under Rule 10b-5, held that the plaintiff could be regarded as a "seller" within the meaning of the Rule. Appraisal was held to be an insufficient remedy because of plaintiff's ignorance of the fraud at the time she demanded the appraisal. 241 F. Supp. at 375.

The District Court in this Circuit recently considered the permissibility of corporate mergers for purposes of enforcing federal securities law. In *Levine* v. *Biddle Sawyer,* 383 F.Supp. 618 (SDNY 1974), which involved a short-form merger, the Court denied defendant's motion for judgment on the pleadings on the ground that the facts presented a "scheme of deceit and concealment". 383 F. Supp. at 622.

Still more recently, in *Kaufman* v. *Lawrence,* 386 F. Supp. 12 (SDNY 1974), *aff'd per curiam,* Slip Op. at 2707 (4/3/75), the District Court refused to grant a preliminary injunction to halt a long-form corporate merger on the grounds that material omission had not been shown, and that the case was not one involving "any hidden or secret action by an outside group to take over control of the company". 386 F. Supp. at 17. The Court concluded pertinently:

> While Sections 10(b) and 14(e) must be read flexibly, and not technically or restrictively, * * * there is nothing invalid *per se* in a corporate effort to free itself from federal regulations, provided the means and the methods used to effectuate that objective are allowable under the law. Nor has the federal securities law placed profit-making or shrewd business tactics designed to benefit insiders, without more, beyond the pale. Those laws in respect of their design and interpretive reach, as I understand them, include the provisions relied on here, and are satisfied if a full and fair disclosure is made, so that the decision of the holders of WRG stock to accept or refuse the exchange offer can be said to have been freely based upon adequate information.
>
> A public company going "private" may indeed raise serious questions concerning protection of the public interest. There is, however, no foundation on the record before me from which the ramifications of that interest within the reach of the federal securities laws might conceivably be explored. . . . *Ibid.* (citations omitted)

Non-disclosure for purposes of deliberate concealment or misrepresentation is the essence of fraud, and synonymous with liability under Section 10b and Rule 10b-5. Against this setting the facts at bar are startling for the picture of unquestionable non-liability under Rule 10b-5 which they present. To reiterate, the defendants—pursuant to a duly enacted state law—effected a merger of a parent corporation and its 95%-owned subsidiary. This transaction is expressly sanctioned by statute, and all statutory requirements were complied with. Complete disclosure regarding valuation of shares was made. There was no attempt to hide the merger, or to misrepresent the minority's right to object and demand appraisal. On the contrary, the minority were expressly informed of their right to do so.

To conclude that this series of events presents a scenario of fraud is a patent distortion of that term. This case presents no claim of fraud at all, and appending the label of "fraud" to plaintiffs' complaint or the majority's opinion does not change the fact one iota. The facts adduced here are wholly unrelated to any cause of action under Section 10 and Rule 10b-5, and legal legerdemain cannot render them otherwise.

II. State Law

The majority concedes that when it speaks of fraud, it does not mean "fraud" at all, but rather a breach of fiduciary duty. Majority opinion at 9, 16. Under the law, breach of fiduciary duty and commission of fraud are wholly different from one another, as was recognized by this Court in *O'Neill* v. *Maytag, supra,* at 339 F.2d 767:

> While the essence of these [fiduciary] duties in some circumstances is honest disclosure, the allegations in the instant case are typical of situations in which deception may be immaterial to a breach of duties imposed under common law principles.

The majority's insistence on extending federal securities anti-fraud provisions beyond the bounds of fraud and into the realms of fiduciary duty is disturbing enough. Accompanied, as it is, by their erroneous finding of a breach of such duty, and by the astonishing and impermissible establishment of a federal common law of corporations—as ill-founded as it is improper—disconcertion must give way to alarm.

There is no question that it is within the proper power of the State to enact statutes regulating corporation mergers. Corporations are creatures of the State. They are created under State law; they are empowered by State statute; and they are regulated by the legislative mandates of the State which has sanctioned their existence. Every State in the Union has comprehensive general business or corporation codes which attest to the exercise of the States' proper responsibilities over the formation of corporate entities and the regulation of corporate activities.

Exercising its unquestionable right to determine the statutory rights and duties of parent and subsidiary corporations chartered under its laws, Delaware has permitted

subsidiaries to dispense with what would be the mere formality of a shareholder vote on merger in those circumstances in which the parent already owns an overwhelming majority of the subsidiary's shares. Delaware law does *not* require that the merger be pursuant to any corporate purpose more limited than the general corporate purposes contained in the corporate charter, which set the boundaries beyond which the corporation will be said to act *ultra vires.* The short-form merger statute is not a procedure designed to effect certain business outcomes; it is the articulation of certain substantive rights which are given to majority and minority shareholders in the State of Delaware[7]—respecting the parent corporation, a right to expedite a merger which is already assured by the parent's overwhelming majority ownership of the subsidiary; respecting the minority, a protective "right to object and demand appraisal". *Coyne* v. *Park & Tilford Distillers Corp.*, 154 A.2d 893, 896 (Del. 1959).

The majority misses the point entirely when it comments, as the justification for sidestepping Delaware law, that "Where Rule 10b-5 properly extends it will be applied regardless of any cause of action that may exist under state law" (citing *Vine* v. *Beneficial Finance Co. supra*). Majority opinion at 6. "Cause of action" means "judicial remedy," not statutory right or compliance with state law, and the *Vine* Court stated the rule correctly when it held that

> [W]e do not regard the existence of a *state remedy* as negating the federal right. *Vine* v. *Beneficial Finance Co.*, 374 F.2d at 635-6 (emphasis supplied)

The substantive rights created by § 253 have been explicitly upheld as a valid regulation of Delaware corpora-

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[7] This was the Court's express holding in *Coyne* v. *Park & Tilford Distillers Corp.*, 154 A.2d 893 (Del. 1959).

tions. The Delaware courts have also explicitly rejected the notion that the exercise of rights accorded by § 253 is itself a breach of duty or a perpetration of fraud. Focusing on the plaintiff's charges of fraud in connection with the statutory merger under § 253, the Supreme Court of Delaware ruled, in the leading case on the subject:

> The complaint, of course, contains allegations of oppressive treatment of the minority by the parent corporation, and a prayer that the merger be set aside. But it is plain that the real relief sought is the recovery of the monetary value of plaintiff's shares—relief for which the statutory appraisal provisions provided an adequate remedy. The Vice Chancellor held that in the circumstances of this case that remedy was exclusive. His analysis . . . was thorough and well-considered, and we agree with it. . . .
>
> [It is argued that] the appraisal remedy under our statutes should not be held to be exclusive.
>
> The answer to this is that the exception above quoted refers generally to all mergers, and is nothing but a reaffirmation of the ever-present power of equity to deal with illegality or fraud. But *it has no bearing here. No illegality or overreaching is shown. The dispute reduces to nothing but a difference of opinion as to value.* Indeed it is difficult to imagine a case under the short merger statute in which there could be such actual fraud as would entitle the minority to set aside the merger. . . . *This power of the parent corporation to eliminate the minority is a complete answer to plaintiff's charge of a breach of trust against the directors of the* [*merged subsidiary*]. . . . *Stauffer* v. *Standard Brands, Inc.,* 187 A.2d 78, 80 (Del. 1962).[8] (emphasis supplied)

[8] *See also, Carl Marks & Co.* v. *Universal City Studios, Inc.,* 233 A.2d 63 (Del. 1967).

This holding accords with the Delaware common law respecting the equitable duty of fiduciaries which, like the statutory law of corporations, lies within the province of the States. Under Delaware law, it is not a *per se* breach of the duty owed the *cestui* for the fiduciary to deal in trust property; in other words, self-dealing is not, by definition, a prohibited activity. Where, for example, the fiduciary has certain already existing rights to acquire the property of the *cestui,* and where these rights are exercised openly and without deception, no violation of the trust results and a court of equity will not enjoin the acquisition.[9] On the contrary, where legal rights attend the parties to a fiduciary relationship, a court of equity will enforce those rights and will not permit a plaintiff to eschew legal rights and duties under the guise of invoking the court's equitable jurisdiction.[10] This is, of course, only an expression of the historic maxim and controlling principle that "Equity follows the law".[11]

To place the plaintiffs' allegations in this case into sharp focus, I would turn for a moment to plaintiffs' complaint. Emerging from plaintiffs' extravagant characterization of defendants' conduct as an "unconscionable self-deal" (3) a "FLAGRANT SELF-DEAL WHICH OPERATED AS A FRAUDULENT DEVICE", "a fraudulent overreaching" (16), an "unconscionable taking without compensation" (19) and a

[9] *See, e.g., In re Thomas,* 311 A.2d 112, 114 (Del. 1973); *Equitable Trust* v. *Gallagher,* 102 A.2d 538, 545 (Del. 1954).

[10] *See, In re Markel,* 254 A.2d 236 (Del. 1969); *Richard Paul, Inc.* v. *Union Improvement Co.,* 91 A.2d 49 (Del. 1952); *Wise* v. *Delaware Steeplechase & Race Ass'n.,* 45 A.2d 547 (Del. 1945).

[11] *See, generally,* 27 Am .Jur. 2d Equity §§ 118, 124; 30 C.J.S. Equity § 103; 13 Atlantic Rptr. Digest, Equity § 62; 30 A.L.R.2d 925; 9 A.L.R.2d 295.

"secret squeeze-out" (31),[12] plaintiffs' claims stand out in bold relief: (1) the merger was "Without any notice or disclosure whatsoever to the minority stockholders of Kirby" (Br. p. 4) and (2) the price of $150 offered was grossly below the $772 value of each share based on plaintiffs' theory of dividing the physical assets proportionately among the stockholders. It is on these grounds that the plaintiffs seek equitable intervention by the courts to effect a rescission of the merger.

As must be plain by this point, neither of plaintiffs' two claims warrants such relief. With respect to prior notice, plaintiffs were entitled to none by law—a not unreasonable provision in light of the fact that, under § 253, the 10% minority shareholder is entitled to fair value of his shares, and *not* to any opportunity to thwart the will of the overwhelming majority.[13] The parent corporation breached no fiduciary duty by exercising its statutory option to acquire the subsidiary without notice. The minority shareholders had no right to prevent such acquisition, or to challenge its legality on statutory grounds. Moreover, the minority shareholders had no right to demand from an equity court an affirmative right to notice in abrogation of the legal rights of the parent corporation, created by statute and recognized at common law and equity by the Delaware Courts.

With respect to the alleged undervaluation of plaintiffs' shares, Delaware law gives the dissenting shareholder a

[12] It should be noted that all of these taken together are insufficient *as a matter of law* to satisfy the pleading requirements of F.R.C.P. 9(b) which mandates that allegations of fraud be supported by factual particulars.

[13] *See*, Borden, "Going Private—Old Tort, New Tort, or No Tort?", 49 N.Y.U.L.R. 987 (Dec. 1974) (hereinafter "Borden") at 1031, n. 194, for an illuminating evaluation of minority shareholders' prerogative to overrule the majority's will in connection with corporate mergers.

right to object, and affords him the legal remedy of appraisal. This is held to be both adequate and exclusive under § 253;[14] equitable relief, absent fraudulent deception or concealment, is unavailable.[15] It is important to stress that the discrepancy in claimed value of the Kirby stock does not *ipso facto* bespeak fraud. Although they refer to going concern value (but without supporting proof), plaintiffs' asserted value appears to be based on the assumption that the Kirby physical assets could be liquidated at the appraisal price and the proceeds divided up amongst the stockholders. However, there is nothing in the record to indicate that Kirby had any intention to liquidate and go out of business or that plaintiffs as holders of 143 shares had any power to compel liquidation. Moreover, under Delaware law a dissenting shareholder cannot recover in appraisal proceedings the "liquidation value" of his shares (*i.e.*, a sum equal to his aliquot share in the value of corporate assets); he is entitled only to "the intrinsic value of [his] shares determined on a *going concern* basis". *Application of Delaware Racing Ass'n.*, 213 A.2d 203, 209 (Del. 1965). (emphasis supplied)

By their complaint plaintiffs have utterly failed to assert any cognizable breach of fiduciary duty; any injury entitling them to equitable relief; any fact whatsoever indicating impermissible overreaching or deception by the defendants. There has been total compliance with state law, complete disclosure of valuation data, and total availability to plaintiffs of Delaware's appraisal procedures. Significantly, all of plaintiffs' assertions of stock value derive from the report circulated by the defendants to the minority shareholders.

[14] *Stauffer* v. *Standard Brands Inc., supra,* at 187 A.2d 80.

[15] *Ibid.*

IV. The Majority's Holding

Notwithstanding all of the above, the majority has purported to find a violation of law that warrants equitable intercession. The majority's theory is that there was a breach of fiduciary duty to the minority because the merger did not have a "justifiable corporate purpose". This purported fiduciary standard is completely untenable; further comment on it will be made *infra*. First and foremost, however, the point must be made that, in taking cognizance of plaintiffs' claim, the majority has not provided a remedy to correct a fraud; rather it has extended to those plaintiffs an independent, substantive right totally unrelated to the anti-fraud scheme of the federal securities laws and in complete derogation of a valid state rule regulating corporate activity.[16] Indeed, the majority appears to have ignored the Supreme Court's decision in *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1939), which put an end to federal common law and forbade the federal courts from formulating their own "better rule."[17]

[16] When it is remembered that some three-quarters of the States have statutes similar to the Delaware short-form merger law, the magnitude of the majority's holding may be readily appreciated. *See* n. 1, *supra*.

[17] The Third Circuit, specifically referring to the law governing fiduciary duty, said as much in the well-known diversity suit of *Zahn* v. *Transamerica Corp.*, 162 F.2d 36, 42 (3d Cir., 1947):

> "In our opinion . . . the law of Kentucky imposes upon the directors of a corporation or upon those who are in charge of its affairs . . . *the same fiduciary relationship* in respect to the corporation and to its stockholders *as is imposed generally by the laws of Kentucky's sister States or which was imposed by federal law prior to Erie R. Co.* v. *Tompkins.*" (citation omitted; emphasis supplied)

See, also, O'Neill v. *Maytag*, 339 F.2d 764, 767 (2d Cir. 1964), wherein we held that:

> "Between principal and agent and among corporate officers, directors and shareholders, *state law has created duties which exist independently of the sale of stock.* While the essence of these duties in some circumstances is honest disclosure, *the allegations in the instant case are typical of situations in which deception [under Rule 10b-5] may be immaterial to a breach of duties imposed under common law principles.*" (emphasis supplied)

That the federal courts' rules, in fact, may not necessarily be "better" is exemplified by the federal test for fiduciary duty adopted by the majority here. *See* this dissent, *infra* at pp. 1996-1999.

Reaching back to *Swift* v. *Tyson*, 16 Pet. 1 (1812), the majority has obviously rejected the valid state standards of Delaware defining fiduciary duty, and the valid state laws regulating the powers of state-created corporate bodies. The majority has tossed these off as so much *obiter dicta* and independently pursued a "better rule", altering the rights of parent corporations and minority shareholders in order to suit the majority's pleasure. The majority's use of the term "fraud" is no more than a smoke-screen; there is no factual foundation presented by the plaintiffs which indicates any fraud in this case. Moreover, under Delaware law, the short-form merger statute is part and parcel of the charter of every Delaware corporation, and of the contract between every such corporation and each of its shareholders.[18] The majority thus is re-drafting corporate charters and private contracts at the same time as it is putting a torch to the teachings of *Erie*. In effect the majority has decided that equity will not follow the law, it will rewrite it.

Their choice for a federal fiduciary standard respecting corporations is the best possible indication of the error of the majority's holding. "Justifiable corporate purpose", as it is used in the majority opinion, is a totally amorphous standard which, although it is nowhere defined in the majority opinion, is nevertheless so inapposite as applied to short-form mergers that it cannot withstand even superficial scrutiny.

[18] *Vocge* v. *American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965); *Greene* v. *Schenley Industries*, 281 A.2d 30, 35, 36 (Del. Ct. Ch. 1971).

The short-form merger procedure permits a corporation to retreat from the public marketplace of securities trading and assume the status of a private company. "Going private", as the process has been popularly labeled, is being more and more frequently resorted to in today's recession economy. The benefits to a corporation are varied. Freedom from worry about the impact of corporate decisions on stock prices; ability to take greater business risks than those sanctioned by federal securities agencies; a switch to more conservative accounting, resulting in lower taxes; the savings which result from no longer having to prepare, print and issue the myriad of documents required under federal and state disclosure laws; the removal of a pressure to pay dividends at the expense of long-term capital development or speculative capital investment—these are some of the advantages which may enure to a corporation "going private".[19] It is essential to underscore that *all* of the above-stated advantages accrue from the *very act of eliminating the 10% shareholders who confer public status on the corporation.* To say that such action is not a "valid business reason" (plaintiffs' complaint) or a "justifiable corporate purpose" (the majority holding) is to completely misapprehend the impact of the shift in status from publicly held corporation to private company. Benefit to the parent company is not incompatible with the notion of "justifiable corporate purpose"; it is a legitimate part of it. As one commentator has noted:

> The selfish motivation is often adverted to in connection with going private, but one wonders why that should be. Are only those corporate transactions to be favored which are not motivated by greed? Must we seek to do public good in order to avoid regulatory

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[19] For an excellent discussion of the phenomenon and its impetus, *see* Borden at 1006-1018.

> sanctions? The questions answer themselves. To observe that greed is a compelling motivation is merely to observe that we live in a free-enterprise society.[20]

It should be obvious that minority shareholders are as similarly motivated as the majority owners, and that their concern is not the purported damage to the public of "going private" transactions—the likelihood of which I seriously doubt—but rather, the equally selfish desire to avoid taking a loss while "playing the market". Such a desire, I submit, is a wholly inadequate justification for according to the 10% a veto power over the will of the 90%. Even our political system does not require 100% consensus before the majority will may be implemented; in fact, such a thought would be completely inimical to the values inherent in our democratic philosophy.

It should be recognized that, in a transaction such as the short-form merger at issue here, the parent corporation does not require any practical power or control over corporate management that it did not already have as a 90% owner. To the degree that the majority condemns "self-aggrandizement" as an effort to acquire control for self-benefit, then the merger *per se* results in no increased aggrandizement at all:

> If the evil in going private is perfecting or ensuring control, it would follow that there would be no wrong when the proponents of the transaction already have an impregnable hold on control. . . .[21]

Whatever "justifiable corporate purpose" may mean, it should be obvious from the above that, as utilized by the majority, it is a completely irrational concept that bears

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[20] Borden, at 1043 (footnote omitted).

[21] *Ibid.* at 1031, n. 194.

no reasonable relationship to the realities of short-form mergers in the actual business world.

I cannot believe that the majority has chosen to exceed the bounds of its jurisdiction under federal law in order to espouse so frail a concept, and I am more convinced than ever of the wisdom which the Supreme Court showed in compelling the federal judiciary to refrain from the business of rewriting state law by judicial fiat.

V. The Concurrence

Judge Mansfield in his concurring opinion falls into the same error as is so obvious in the majority opinion, namely, that "a short-form merger consummated without any legitimate purpose and without any advance notice to the minority public stockholders, resulting in harm to the latter, violates Rule 10b-5." In short, any use of the Delaware statute is fraud *per se,* tantamount to a "device, scheme or artifice to defraud" and a course of business conduct that operates "as a fraud or deceit".

Particularly disturbing is the unfounded hypothesis that the merger was intended to take improper advantage of market conditions by the deliberate tender to plaintiffs of a grossly inadequate price for their shares. Plaintiffs themselves do not go so far by way of allegation.

Judge Mansfield in footnote 4 argues the inadequacy of an appraisal proceeding in fixing a fair market price and straightaway concludes that a federal court "would be required to determine a fair buy-out price"—the very determination which the Delaware law provides. On such a hearing the same items of proof would undoubtedly be offered: purchases and sales of Kirby stock by willing purchasers and sellers on or off public trading markets over a period of time; annual earnings per share in years good and bad; price/earnings ratios; projected earnings;

and the physical asset value, as appraised, of $320,000,000.[22] The trial would have become a battle of experts, financial, accounting and physical property appraisers, but with the judicial system of Delaware available for this purpose it would not have lacked due process. Where there are disputes between parties as to fair values the courts not infrequently become the final arbiters, but the courts of the Second Circuit should not appropriate unto themselves the exclusive right and competence to engage in such determinations.

In summary, in my opinion, both majority and concurring opinions depart widely from the Congressional purpose in enacting Section 10b, from our own decisions thereunder and from the Supreme Court's interpretation thereof—thus far.

I would affirm the District Court's dismissal of plaintiffs' complaint.

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[22] Public financial information makes available the fact that many stocks publicly traded sell at prices only a fraction of their book value, whereas others sell at prices far in excess thereof.

Appendix D—Memorandum of the Court of Appeals Denying the Petition for Rehearing En Banc.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the tenth day of March, one thousand nine hundred and seventy-six.

75-7256

S. WILLIAM GREEN, et al.,
Plaintiffs-Appellants,

v.

SANTA FE INDUSTRIES, INC., et al.,
Defendants-Appellees.

75-7404

ARNOLD MARSHEL,
Plaintiff-Appellant,

v.

AFW FABRIC CORPORATION, et al.,
Defendants-Appellees.

BARRY L. SWIFT,
Plaintiff-Appellant,

v.

CONCORD FABRICS, INCORPORATED, et al.,
Defendants-Appellees.

A poll of the judges in regular active service having been taken at the request of one of them, as to whether this action should be reheard en banc, and there being no majority in favor thereof, it is

Ordered that rehearing en banc is denied.

Chief Judge Kaufman and Circuit Judge Gurfein did not participate in the poll.

PER CURIAM:

This Court has denied en banc, not because we believe these cases are insignificant, but because they are of such extraordinary importance that we are confident the Supreme Court will accept these matters under its certiorari jurisdiction, as we correctly anticipated in *Eisen* v. *Carlisle & Jacquelin,* 479 F.2d 1005, 1020 (2d Cir. 1973), *vacated,* 417 U.S. 156 (1974).

Even under the best of circumstances, an en banc proceeding is often an unwieldy and cumbersome device generating little more than delay, costs, and continued uncertainty that can ill be afforded at a time of burgeoning calendars. A case in which Supreme Court resolution is inevitable should not be permitted to tarry in this Court for further intermediate action, at best, except when the views of this Court would be of real benefit to the Supreme Court. And, en banc is particularly inappropriate and unsatisfactory in the cases before us, since two of our active judges are disqualified from participating. With four senior judges sitting if these cases had been en banced, the law of the circuit might well be charted with the concurrence of only a minority of the active judges—defeating the very purpose the en banc procedure is designed to serve.

Appendix D.

Moreover, the applications for certiorari that we expect inexorably to follow our action will not reach the Supreme Court devoid of the views of the judges of this Court. In contrast to the Pentagon Papers case—where this Court convened en banc but, due to urgent considerations of time, did not write opinions—these cases will go to the Supreme Court with full and thoughtful expositions of the opposing views of several members of this Court.

Accordingly, we speed these cases on their way to the Supreme Court as an exercise of sound, prudent, and resourceful judicial administration.